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670251—63——1

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

DOROTHY ANNE STAPF AND B. T. WARE, II, EXECUTORS AND TRUSTEES OF THE ESTATE OF LOWELL H. STAPF, DECEASED, AND DOROTHY ANNE STAPF, INDIVIDUALLY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the district court (R. 53–80)[1] is reported at 189 F. Supp. 830. The opinion of the court of appeals (App. 6a–44a) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on September 26, 1962 (App. 44a). By order of Mr.

[1] "R." refers to the printed Transcript of Record filed in the court of appeals; "App.", to the appendix to this petition.

Justice Stewart, dated December 21, 1962, the time for filing a petition for certiorari was extended to and including January 9, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether a devise of property to a surviving spouse on condition that she convey property of equal value to a third party qualifies as a "gift to such spouse" deductible from the decedent's gross estate under § 812(e) of the Internal Revenue Code of 1939.

2. Whether claims against the community estate for which the wife's half of community property is equally liable but which the decedent's will directs to be paid entirely from his half are deductible in full from the decedent's gross estate as "claims against the [decedent's] estate" within the meaning of § 812(b) of the Code.[2]

STATUTES AND REGULATIONS INVOLVED

Sections 812(b) and 812(e) of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.), and §§ 81.36, 81.47a, and 81.47c of Treasury Regulations 105 are set forth in part in App. A, *infra*, pp. 1a–5a.

STATEMENT

The decedent, a resident of Texas, died on July 29, 1953. By his will, he sought to dispose of both

[2] The following related question, although not separately discussed in this petition (see note 4, *infra*), is also preserved:

3. Whether administration expenses which are chargeable in part against the wife's half of the community property but which the decedent's will directs to be paid entirely out of his half are deductible in full from the decedent's gross estate as "administration expenses" under § 812(b) of the Code.

his separate property and the entire community property of himself and his wife, expressly putting her to an election whether to take under the will or simply to take her share of the community estate. The wife survived and elected to take under the will. (R. 12–13, 37.)

The value of the husband's separate property was $60,000.[3] The gross value of the community property was $258,000, but there were community obligations totaling $36,000.[4] Thus the wife, had she elected not to take under the will, would have retained a one-half interest in the community estate, that share having a gross value of $129,000. Her interest would have been burdened with half the community obligations, leaving a net value to her of $111,000. (R. 87, 91, 93.)

Under the terms of the will, the wife was given one-third of all the property dealt with by the will (*i.e.*,

[3] The actual figures have been slightly modified for the sake of arithmetical simplicity. We have also ignored (and adjusted the figures accordingly) certain specific bequests (totaling about $8,000) and the specific bequest to the wife of the husband's half of an automobile owned as community property. None of those details is material to the issues presented here.

[4] The $36,000 actually includes not only community debts (*i.e.*, liabilities antedating the husband's death) but also some $4,000 of expenses incurred in the administration of the probate estate and the wife's half of the community property administered with it. Since some part of those expenses (though not necessarily half) were chargeable to the wife's half of the community property, the deduction in full of those expenses presents substantially the same question as the deduction in full of the community debts. For that reason, and in the interests of simplicity, we have in the discussion in this petition ignored the separate identity of the administration expenses and treated the entire $36,000 as consisting of pre-existing debts.

the entire community estate of $258,000 plus the husband's separate property of $60,000, a total value of $318,000); thus she received property having a value of $106,000. Of the remaining two-thirds, the residue (after payment of debts, taxes, and expenses) was given to trustees for three named children. The will provided that if the wife elected to take under its provisions, all claims against the estate, including community obligations, should be paid out of the decedent's one-half interest in the community property. (R. 13–14, 21–22, 92.) The wife, as noted above, elected to take under the will.

In its estate tax return, the husband's estate claimed a marital deduction under § 812(e) of the Internal Revenue Code of 1939[3] for the one-third ($20,000) of the husband's separate property that passed to the wife under the will. It also claimed a deduction for the entire $36,000 of community obligations as "claims against the estate" under § 812(b). The Commissioner of Internal Revenue disallowed the marital deduction and half of the "claims" deduction (*i.e.*, the portion of the claims attributable to the wife's half of the community property). (R. 58, 70, 87–88, 93–94.) The district court, in a suit for refund duly brought, allowed the marital deduction but upheld the Commissioner's partial disallowance of the claims deduction (R. 99). The court of appeals, reversing in part, held that both of the claimed deductions were allowable in

[3] Unless otherwise indicated, all section references will be to the Internal Revenue Code of 1939 (as amended, 26 U.S.C., 1952 ed.). The successor provisions of the 1954 Code are substantially identical.

full (App. 6a–18a). Judge Wisdom dissented; he would have disallowed both of the contested deductions (App. 18a–44a).

REASONS FOR GRANTING THE WRIT

The decision below is patent in its error and threatens an extraordinary and damaging impact upon the estate tax system. If allowed to stand, it will invite widespread modification of wills to take advantage of the unprecedented tax savings it offers. The need for prompt review and correction by this Court is urgent.

I. THE MARITAL DEDUCTION

Section 812(e) of the Code allows a deduction, up to one-half of the adjusted gross estate, for "the value of any interest in property which passes * * * from the decedent to his surviving spouse." In this case, Mrs. Stapf was bequeathed by her husband one-third of his separate property, worth $20,000, on condition that she relinquish in favor of the children an interest in community property worth $25,000*—*i.e.* that

*Had the wife not taken under the will, she would have received one-half of the community assets of $258,000 less one-half of the community debts of $36,000, a net interest of $111,000. Taking under the will, she received community property worth only $86,000 (one-third of the total community assets of $258,000, free of community debts). Thus she had to relinquish $25,000 worth of community property (from $111,000 to $86,000) in order to receive $20,000 worth of the husband's separate property.

The discrepancy is the same if the "exchange" is viewed in terms of the gross amounts involved (a relinquishment of $111,000 of community property to receive $106,000 under the will), but we have used the net amounts to conform to the court of appeals' view that "under the Texas law the devise of

she give them $25,000 worth of her own property. She elected to comply with the condition and thus suffered a net loss of $5,000. Though it cost her $25,000 to receive it, the court of appeals held that the bequest to the wife of $20,000 worth of her husband's property qualified in full for the marital deduction under § 812(e). As we will show, not only does that decision ignore the whole purpose of the marital deduction and create a gaping loophole but it contravenes a specific provision of the statute expressly limiting the marital deduction to the net value (here, zero) of conditional or burdened bequests.

1. The purpose of the marital deduction was to extend to taxpayers in common-law jurisdictions the advantages of estate "splitting" previously enjoyed only by taxpayers in community-property jurisdictions—namely, the lower total tax resulting from the application of progressive rates separately to two halves rather than to one whole.[7] The purpose being only to permit the property of a husband and wife to be taxed in two piles, and not to allow it to escape taxation altogether in the spouses' generation, it was of the essence that the deduction should be limited, as it was, to gifts to a spouse and then only if the interest given was of such a nature that it would be

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one-third of the whole community to the widow [*i.e.*, $86,000] did not pass to her under the will but was satisfied out of her own one-half". (App. 15a).

[7] See H. Rep. No. 1274, 80th Cong., 2d Sess., pp. 24–26; S. Rep. No. 1013, 80th Cong., 2d Sess., pp. 26–29. For an earlier attempt to eliminate the discrimination, by a different means, see § 402(b), Revenue Act of 1942, 56 Stat. 942; H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 35–37.

taxable in the spouse's estate (*i.e.*, not a "terminable" interest, § 812(e)(1)(B)).[8]

The decision below destroys all limitations upon the marital deduction and converts it from an estate-splitting device into an escape hatch through which one-half the estate of any married person may escape taxation entirely regardless of the disposition made of it. What the court holds is that a testamentary gift to anyone can be made to qualify for the marital deduction by the simple device of having it "pass through" the surviving spouse—*i.e.*, by giving property to the spouse on condition that he or she convey property of equal value to the ultimate beneficiary. The availability of the device is not limited to community-property jurisdictions nor even to cases in which the wife has property of her own.[9] The wife need receive no benefit at all (as she did not here), and it is no objection that even the interest of the ultimate beneficiaries is a "terminable" one (as it was in this case). There must, of course, be a surviving spouse through whom to funnel the gifts to the ultimate beneficiaries, but so long as there is a surviving spouse the decedent can dispose of his entire estate however and to whomever he pleases (*e.g.*, in trust for as many generations of descendants as the rule against perpetuities will permit), give nothing to

[8] See Warren & Surrey, *Federal Estate and Gift Taxation* (1961), pp. 749, 759–760.

[9] If a wife having no independent property were given say, $100,000 in cash on condition that she convey $100,000 worth of General Motors stock to her son, she could still comply with the condition by using the $100,000 given her (or borrowing against it) to buy the required stock.

his spouse, and still make full use of the marital deduction so that only one-half of his estate will be taxed. The only requirement is that he preface the dispositive provisions of his will with a provision giving the property to his spouse "on condition" that the spouse convey property of equal value in the manner directed by the remaining provisions.[10]

The effect of the decision below, as the court itself acknowledges (App. 17a), is that property equal to one-half the estate of the first spouse to die may be transmitted to the children (or even more remote descendants) without being subject to either gift or estate taxes in the estate either of the husband or the wife. If there be another decision more drastic in its implications for the gift and estate tax system, we are unaware of it.

2. That the statute was never intended to permit a deduction for a bequest that, in economic reality, merely "passes through" the surviving spouse to a third party would be clear enough from the basic scheme of the statute even if there were no provision explicitly dealing with the question. The error of the decision below is compounded, however, by its emasculation of a provision included in the statute for the very purpose of forestalling such a result. Section 812(e)(1)(E) provides:

> * * * In determining * * * the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this

[10] The wife's cooperation is of course required, but that could be assured, if necessary, by making the gift to her of slightly greater value than the required conveyance.

> subsection— * * * (ii) where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such incumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

On its face, that provision seems plainly to say that only the net value of a burdened bequest to a spouse may be deducted. And so the regulations, in even more express terms, have interpreted it, giving as an example the very facts of this case (a bequest conditional upon the wife's election to relinquish her interest in community property). Regs. 105, § 81.47c (b) (examples 1 and 3), *infra*, App. 4a–5a. If the regulations are valid, they are dispositive of this case.

The court of appeals, however, held the regulations invalid, basing its decision on the direction in the statute that an obligation imposed upon a bequest to a spouse "be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined." The court reasoned that if the husband had made an *inter vivos* transfer of property worth $20,000 to the wife on condition that she convey property of equal value to the children, and the question had been whether the husband was "liable for gift taxes on the full value" of the $20,000 transfer (App. 17a), the answer would have been "yes." That of course is true, for in the supposed case there would be no doubt that the husband had made a $20,000 gift *to someone*. There is equally no doubt, however, that

the *donee* of the gift would be the children, not the wife. It is they, for example, who would be secondarily liable for the gift tax (see § 1009), and it is in their role (the ultimate beneficiaries) and not the wife's (the intermediary) that the husband's alma mater would have to be substituted to make the gift deductible as a charitable contribution.[11] In its essence, the supposed transaction would amount simply to the husband's purchase of property from his wife and his gift of the purchased property to the children.

The essential error of the court of appeals' reasoning thus lies in its inexplicable disregard of the words "to such spouse" in the statutory phrase on which it relied. Section 812(e)(1)(E)(ii) asks not whether a husband would be held to have made a gift (or a gift in the full surface amount) *to someone;* it asks whether he would be held to have made a gift (or a gift in the full surface amount) *to his wife.* Quite plainly, the answer in this case would be "no." See *Helvering* v. *Hutchings,* 312 U.S. 393, 396; Regs. (1954 Code), § 25.2511–1(h)(2), (3).[12] It follows, under the

[11] See §§ 23(o) (income tax), 812(d) (estate tax), and 1004(a)(2) (gift tax).

[12] *Commissioner* v. *Wemyss,* 324 U.S. 303, on which the court of appeals relied, is not to the contrary. There a widow had an income interest in a trust that would terminate upon her remarriage (the interest succeeding to her child by the former marriage). To induce her to marry him, the taxpayer gave the widow securities in an amount sufficient to replace the income she would lose. The Court held that, since marriage (the only benefit flowing to the taxpayer) was not a consideration in "money's worth," the transfer of the securities was a taxable gift. But the Court did not decide (as it had no need to decide) that the taxpayer had made a gift *to the widow;* it being plain enough that he had made a gift to some-

express terms of § 812(e)(1)(E)(ii), that for marital deduction purposes the value of the property passing to Mrs. Stapf ($20,000) must be reduced by the value of the property she was required to relinquish to obtain it ($25,000). Since that leaves a negative value,[12] the estate is entitled to no marital deduction.

II. The Deduction for Claims Against the Estate

Section 812(b)(3) of the Code allows a deduction from the gross estate of such amounts "for claims against the estate * * * as are allowed by the laws of" the State. Here, the total community property of $258,000 was subject to community debts of $36,000. Only one-half of the community property, or $129,000, was includible in the decedent's estate. His will, however, directed the executors to pay all of the com-

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one, either to her or to the child. In that case, moreover, it would have been quite permissible to view the gift as having been to the widow; the reason is that, unlike here, the bargained-for consideration (albeit not qualifying as "money's worth" consideration for gift tax purposes) was the *marriage*, not the relinquishment of the trust interest (which followed only as an unavoidable consequence of the marriage). Be that as it may, the Court's actual decision, limited to the existence of a taxable gift *vel non*, has no bearing on the issue here.

[12] The consequence, as the court below recognized (App. 17a), is that Mrs. Stapf was herself liable for a gift tax on the excess of the value of the property relinquished by her in favor of the children over the value of the property received by her. The court's concession that Mrs. Stapf was liable for a gift tax only on the $5,000 excess, we might observe, actually undermines its entire holding. The children obviously were donees of $25,000, and if the wife was a donor only of $5,000, the donor of the remaining $20,000 can only have been the decedent. By the same token, the donees of the husband's $20,000 gift were necessarily the children, not the wife.

munity debts "out of" his half of the community property. Because of that direction, the court below held that the estate was entitled to deduct the entire $36,000 of the community debts as "claims against the [decedent's] estate" under § 812(b)(3).

1. Even treating the will's direction for the payment of the debts as an operative provision, as the court of appeals did,[14] the decision below is clearly wrong. The straightforward, obvious purpose of the statute is to limit the estate tax to property over which the decedent possessed testamentary power at his death, or over which he has previously exercised the equivalent thereof; and the plain meaning of § 812 (b)(3) is that the gross estate is to be reduced by the amount of claims for which the estate is liable, under State law, on account of non-testamentary obligations

[14] In fact, the direction seems to have been quite without consequence. It did not apply if the wife did not elect to take under the will, and it did not affect the distribution under the will if she did. The will directed (1) that the wife be given one-third of the gross probate estate (including the entire community); (2) that the debts, expenses, and taxes then be paid; and (3) that the residue be given to trustees for the children. Since the wife's bequest was to be determined and satisfied before payment of the debts, which of the remaining assets were used for that purpose was a matter of indifference to her. And since the children got the residue of "her" share of the community as well as of "his," which share was charged with the debts could likewise have no effect upon what they got. To show the even more basic error of the court of appeals' decision, however, we will assume that the debt-payment provision was not contingent upon the wife's taking under the will. Without the election provision, the husband's assumption of all the community liabilities would have operated to increase the wife's share of the community property from $111,000 ($129,000 less $18,000 share of the debts) to $129,000 (one-half of the community free of debts).

incurred by the decedent before his death.[13] Claims reduce the property subject to testamentary control and are therefore deductible; they are to be distinguished from legacies, which are exercises of testamentary control and therefore not deductible.

Under the community property law of Texas, a wife's share of the community is chargeable with half the community debts. Although the wife is not personally liable and the husband is, satisfaction of community debts out of the husband's estate creates a right over against the wife's share (see App. 12a, 22a–23a). Accordingly, it has not been disputed that, without a special provision in the husband's will, the community debts would have been shared equally by both halves of the community and the husband's estate would have been entitled to a deduction for only one half, or $18,000, of the debts. See App. 28a (dissenting opinion) and authorities cited.

The effect, then, of the provision for payment of the entire $36,000 out of the husband's share of the property was to relieve the wife's half of the community of an $18,000 charge upon it, and thus to augment the value of the wife's property by that amount. But that consequence is no different from that of a pecuniary legacy to the wife of $18,000; and a legacy is none the less a legacy—a testamentary gift of property over which the husband at his death possessed full dispositive power—because it takes the form of a

[13] "The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death * * *. Only claims enforceable against the decedent's estate may be deducted." Regs. 105, § 81.36.

testamentary assumption of claims against the legatee's property.

Of course, the $18,000 of community obligations chargeable against the wife's estate were "claims." They were not, however, "claims against the estate" of the husband, within the meaning of the estate tax law. There was thus no occasion to reach the question whether they were "allowable under the law" of Texas—whether, that is, Texas law permits (as of course it does) a redistribution of property between a widow and other legatees by use of the device employed here. Obviously, Texas law permits and requires executors to satisfy legacies as well as claims. The problem here is to distinguish between the two, and the inquiry is not advanced by the discovery that state law sanctions the payment (see App. 12a).

2. The potential of the court of appeals' holding for discrimination and for tax avoidance is plain. For example, a husband in a common-law State who leaves a gross estate of $1,000,000 subject to claims of $500,000, and who takes full advantage of the marital deduction, has a net taxable estate of $250,000. The counterpart situation in a community-property State is that involving $1,000,000 gross community property and $500,000 community debts. Without a testamentary assumption such as that in this case, the husband's net taxable estate is likewise $250,000 ($500,000 is his share of the gross community, and $250,000 is his share of the community debts). But if the community-property husband's will provides for payment of all the community debts, the result,

according to the court of appeals, is that his net taxable estate is zero [$500,000 (husband's share of community) less $500,000 (all community debts)].[16] Achievement of that result does, it is true, require the community-property husband to give his wife the entire net community;[17] but the comparable common-law husband could not, even by giving his wife everything, reduce his net taxable estate below $250,000.

The community-property husband's transfer to his wife via the debt assumption would, of course, qualify for the marital deduction to the extent that one were available. The marital deduction is limited, however, to one-half the "adjusted gross estate" (§ 812(e)(1)(H)) and that term excludes community property (§ 812(e)(2)), so that a marital deduction is available only up to one-half the value of the separate property in the estate, if any. Thus the alternative eligibility for a marital deduction does not remove the importance of the claims-deduction question. And in this case, of course, although there was separate property there could be no marital deduction for the reasons discussed in the preceding point (namely, that the wife gave up more than she got).

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[16] As Judge Wisdom has demonstrated, astute taxpayers can arrange for this extreme result without serious inconvenience by being careful to maintain community assets and liabilities approximately in a two-to-one ratio (a condition which can easily be brought about by borrowing on the security of community assets). See App. 30a (dissenting opinion).

[17] At least in theory, although the court of appeals here allowed the deduction notwithstanding that the wife actually received nothing from the purported debt assumption (see note 14, *supra*).

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CONCLUSION

Only rarely does the government find itself constrained to request this Court to review a tax decision which raises no conflict with a decision of another court of appeals. This petition is an unusual one, predicated on what the government regards as an urgent need for immediate reversal of the court of appeals' decision. The issues turn on simple, but basic and far-reaching, questions of statutory purpose directly affecting the integrity of the estate tax structure. As long as they are permitted to stand, the court of appeals' demonstrably incorrect holdings will have a potential for glaring inequity and devastating loss of revenue.

The issues were thoroughly canvassed before the court of appeals, to the point of supplemental briefs submitted after oral argument; and they were decided by a full opinion delivered over an exhaustive and vigorous dissent. As to one of the issues, the court below is one of only two courts of appeals in which the issue is likely to arise.[18] Postponement of consideration by this Court thus holds out far less promise than usual of useful further refinement and elucidation of the issues.

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[18] The States having community-property laws are California, Nevada, New Mexico, Arizona, Idaho, Washington, Louisiana, and Texas. Louisiana and Texas are in the Fifth Circuit. The rest are in the Ninth Circuit except for New Mexico, which is in the Tenth.

Finally, the decision below portends especially unfortunate consequences for estate tax administration even if allowed to stand only temporarily. The methods which the court of appeals has now held will produce breathtaking estate tax savings are easily grasped and will surely be followed by estate planners everywhere. Refusal now to correct the court of appeals' erroneous holdings will strengthen the expectations stemming from them, and give them time to induce important reliance by testamentary draftsmen. When later this Court, or Congress, does deal with the issues, it will confront the choice of either upsetting expectations already written into the wills of numerous testators of whom many may have died, or else cementing into the law (at least retroactively) two gaping holes through which will be pouring inequitable tax savings not intended by Congress.

For the reasons stated, this petition for a writ of certiorari should be granted.

Respectfully submitted,

ARCHIBALD COX,
Solicitor General.

LOUIS F. OBERDORFER,
Assistant Attorney General.

WAYNE G. BARNETT,
Assistant to the Solicitor General.

ROBERT N. ANDERSON,
Attorney.

JANUARY 1963.

APPENDIX A

INTERNAL REVENUE CODE OF 1939 (AS AMENDED, 26 U.S.C., 1952 ED.)

SEC. 812. NET ESTATE.

For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

* * * * * *

(b) [as amended by Secs. 405(a), 406, Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 502, Revenue Act of 1950, c. 994, 64 Stat. 906]. *Expenses, Losses, Indebtedness, and Taxes.*—Such amounts—

(1) for funeral expenses,
(2) for administration expenses,
(3) for claims against the estate, and
(4) for unpaid mortgages upon, or any indebtedness in respect to, property where the value of decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,

as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered, but not including any income taxes upon income received after the death of the decedent, or property taxes not accrued before his death, or any estate, succession, legacy, or inheritance taxes. The deduction herein allowed in the case of claims against the estate, unpaid mortgages, or any indebtedness shall, when founded upon a promise or

agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth; * * *. There shall be disallowed the amount by which the deductions specified in paragraphs (1), (2), (3), and (4) exceed the value, at the time of the decedent's death, of property subject to claims. For the purposes of this section the term "property subject to claims" means property includible in the gross estate of the decedent which, or the avails of which, would, under the applicable law, bear the burden of the payment of such deductions in the final adjustment and settlement of the estate; and, for the purposes of this definition, the value of the property shall be reduced by the amount of the deduction under the next sentence attributable to such property. * * *

For the purposes of this subchapter, a relinquishment or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, shall not be considered to any extent a consideration "in money or money's worth."

* * * * *

(e) [as added by Sec. 361(a), Revenue Act of 1948, c. 168, 62 Stat. 110] *Bequests, Etc., to Surviving Spouse.*—

(1) *Allowance of marital deduction.*—

(A) *In General.*—An amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

* * * * *

(E) *Valuation of Interest Passing to Surviving Spouse.*—In determining for the pur-

poses of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—

* * * * *

(ii) where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such incumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

* * * * *

TREASURY REGULATIONS 105 (1939 CODE)

SEC. 81.36. *Claims against the estate.*—The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, whether or not then matured, and interest thereon which had accrued at the time of death. * * * Only claims enforceable against the decedent's estate may be deducted. Except as hereinafter stated, if the claim is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. * * *

SEC. 81.47a [as added by T. D. 5699, 1949–1 Cum. Bull. 181, 195]. *Bequests, etc., to surviving spouse.*—(a) *Allowance of marital deduction.* In the case of the estate of a citizen or resident of the United States dying after December 31, 1947, there may be deducted the value of any property interest (except as otherwise provided in section 81.47b and 81.47d) which passed from the decedent to his surviving spouse. Such deduction is hereinafter referred to as the "marital deduction." The marital deduction is gen-

erally not available in case the decedent's gross estate consists exclusively of property held by him and his surviving spouse as community property under the law of any State, Territory, or possession of the United States, or any foreign country. (See section 81.47d.) * * *

* * * * *

SEC. 81.47c [as added by T. D. 5699, 1949–1 Cum. Bull. 181, 206]. *Valuation of property interest passing to surviving spouse—*

* * * * *

(b) *Property interest subject to an incumbrance or obligation.* Section 812(e)(1)(E) provides that where a property interest passed from the decedent to his surviving spouse subject to a mortgage or other incumbrance, or where an obligation is imposed upon the surviving spouse by the decedent in connection with the passing of a property interest, the value of such property interest is to be reduced by the amount of such mortgage, other incumbrance, or obligation. The passing of a property interest subject to the imposition of an obligation by the decedent does not include a bequest, devise, or transfer in lieu of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate. The passing of a property interest subject to the imposition of an obligation by the decedent does, however, include a bequest, etc., in lieu of the interest of his surviving spouse under community property laws unless such interest was, immediately prior to the decedent's death, a mere expectancy. * * *

The following are illustrative of property interests which passed from the decedent to his surviving

spouse subject to the imposition of an obligation by the decedent:

(1) A decedent devised a residence valued at $25,000 to his wife, with a direction that she pay $5,000 to his sister. For the purpose of the marital deduction, the value of the property interest passing to the wife is only $20,000.

* * * * *

(3) A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife.

* * * * *

APPENDIX B

In the United States Court of Appeals for the Fifth Circuit

No. 18974

UNITED STATES OF AMERICA, APPELLANT-APPELLEE,

versus

DOROTHY ANNE STAPF AND B. T. WARE, II, EXECUTORS AND TRUSTEES OF THE ESTATE OF LOWELL H. STAPF, DECEASED, AND DOROTHY ANNE STAPF, INDIVIDUALLY, APPELLEES-APPELLANTS (AND REVERSE TITLE)

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS

(September 26, 1962)

Before BROWN, WISDOM, and BELL, *Circuit Judges.*

BELL, *Circuit Judge:* This is an estate tax case. The opinion of the District Court is reported at 189 F. Supp. 830. Suit was filed by the executors of the estate of Lowell H. Stapf for a refund of estate taxes and interest paid pursuant to a deficiency asserted against the estate.

All facts have been stipulated. Mr. Stapf died testate on July 29, 1953, a Texas resident and domiciliary. His will was probated in Texas where his principal estate consisting of separate and community property, was situated. His will put his wife to an

election [1] either to elect not to take under the will and thereby retain her one-half interest in the community estate, or to allow her one-half interest to be disposed of under his will in order that she might receive specified benefits thereunder.

The benefits included one-third of the residue, consisting of the whole of the community property, and separate property of a value of $65,100 owned by the decedent, less specific bequests. The benefits also included an automobile, itself community property in which the widow owned a one-half interest. The will provided that if she should elect to take under its provisions, all funeral expenses, costs of administration and claims against the estate, whether community or separate, should be paid out of the one-half interest of decedent in the community property. Community debts totalled $32,367.74, while expenses of administration, including attorneys' fees, were $4,073.47 and the community of the husband was sufficient to pay these.

Electing not to take under the will, the widow would have retained her one-half of the community property, subject to its pro-rata share of expenses of administration and one-half of the community debts, having a net value of $111,442.68. Taking, she became entitled to one-third of the gross value of decedent's separate estate ($21,666.66), the one-half interest of the husband, valued at $700 in the community automobile, and one-third of the combined community estate. This had a value of $106,268.18, or $5,174.50 less than the value of the interest Mrs. Stapf would have retained had she not elected to take under the

[1] The doctrine of election under the Texas law is well established. See *Dakan* v. *Dakan*, 1935, 125 Tex. 305, 83 S.W. 2d 620; *Smith* v. *Butler*, 1892, 85 Tex. 126, 19 S.W. 1083; and 44 Tex. Jur., Wills, § 285 et seq.

will. Computed differently but with the same result, the widow retained a one-third interest out of the one-half of the community owned by her, thereby transferring only a one-sixth interest under the election to take. Under this method of computation she transferred property having a valuation of $27,541.16 and received property being the one-third interest in the separate property of the husband and the one-half interest in the automobile of the aggregate value of the $22,366.66, making a net loss to her of $5,174.50. The government uses one method while the taxpayer uses the other. Either is sufficient for our purposes.

The taxpayer, having been notified of a deficiency after filing the estate tax return, paid the deficiency and claimed a refund. It being denied, suit was filed and this appeal is from the judgment of the District Court. The taxpayer appeals from the disallowance of the community debts and administration expenses as deductions from the gross estate of decedent under § 812(b) of the Internal Revenue Code of 1939, 26 USCA, § 812(b). The government appeals from the allowance of an exclusion from the gross estate as a part of the marital deduction of the one-third of the separate property of decedent and the one-half interest in the community automobile passing to the widow under her election to take under the will, contending that this devise was incumbered or obligated within the meaning of § 812(e)(1)(E)(ii) of the Internal Revenue Code of 1939, 26 USCA, § 812(e)(1)(E)(ii), in an amount exceeding the value of the devise received by the widow in that the property transferred by her was of a greater value than that received by her.

As to the deductibility of the total of the debts and expenses from the community of decedent alone,[2] § 812 of the Internal Revenue Code of 1939, as amended, being the applicable statute, provides in part:

> "§ 812 NET ESTATE
>
> "For the purpose of the tax value of the net estate shall be determined, * * * by deducting from the value of the gross estate—
>
> "(b) * * * such amounts—
>
> "(1) for funeral expenses
>
> "(2) for administration expenses,
>
> "(3) for claims against the estate,
>
> "as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered, * * *. The deduction herein allowed in the case of claims against the estate * * * shall, when founded upon a promise or agreement, be limited to the extent that they are contracted bona fide and for an adequate and full consideration in money or money's worth * * *.

This section is the same as § 303 of the Revenue Act of 1926 with respect to which it was said in *First-*

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[2] The debts of decedent totalled $32,367.74, all of which were community debts, including $23,701.34 due for 1951 income taxes, and interest thereon in the amount of $1,955.33. The expenses of administration totalled $4,073.47. The Commissioner determined that 65 percent of the expenses of administration should be allocated to and deducted from the gross estate of decedent, and the remaining 35 percent allocated to the widow's one-half of the community estate. This allocation was affirmed by the District Court and the allocation is conceded to be correct if the expenses are not deductible. Ad valorem taxes due amounted to $1,954.96.

[3] Allowed *in toto* here. *Blair* v. *Stewart*, 5 Cir. 1931, 49 F. 2d 257.

Mechanics Nat. Bank of Trenton v. *Commissioner of Internal Revenue*, 3 Cir., 1940, 117 F. 2d 127:

> "Unquestionably a claim against a decedent's estate which is allowed by the laws of the jurisdiction under which the estate is administered is deductible in determining the net estate subject to federal tax. The Revenue Act applicable to the instant case specifically so provides."

Cf. *Blair* v. *Stewart*, Footnote (3), supra; and *Lang's Estate* v. *Commissioner of Internal Revenue*, 9 Cir., 1938, 97 F. 2d 867, on appeal from the Board of Tax Appeals, 34 B.T.A. 337. Thus, uniformity in the application of the statute was not expected by the Congress, and we look to the law of Texas to determine this issue.

The principle that community debts are deductible in their entirety from the community interest of the decedent in determining estate tax liability where directed by the provisions of the will was recognized, although not applied, in *Lang's Estate* v. *Commissioner*, supra:

> "On this issue we think the Board was correct in permitting a deduction of only one-half of these community obligations. Regardless of the incidents of the husband's personal liability for community debts during his lifetime, Section 1342, Remington's Revised Statutes, supra, as construed by the Supreme Court of Washington, requires that community debts be satisfied pro rata from that portion of the community property distributable to the wife and that portion subject to the husband's testamentary disposition. It is only by provision of a deceased husband's will that a community debt may be charged solely against his share of the community. Redelsheimer v. Zepin, 105 Wash.

199, 202, 177 P. 736; In re Hart's Estate, 150 Wash. 482, 492, 273 P. 735."

There was no provision in the will in that case to charge the whole of the claims against the community of the decedent, but the holding was that the claims in any event were not personal obligations of the decedent within the meaning of the Washington law as required by the regulation.

The Applicable Treasury Regulation, 105 (1939 Code), provides in pertinent part:

> "SEC. 81.29 *Deduction of administration expenses, claims, etc.*—In order to be deductible * * * the item must fall within one of the several classes of deduction * * * enumerated * * * and must also * * * be one of payment of which out of the estate is authorized by the laws of the jurisdiction under which the estate is being administered. Unless both of these conditions exist the item is not deductible. * * * If a claim against the estate, an unpaid mortgage, or an indebtedness is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth, * * * ."
>
> "SEC. 81.32 *Administration Expenses.*—* * * Administration expenses include (1) executor's commissions; (2) attorney's fees; (3) miscellaneous expenses. * * * "
>
> "SEC. 81.36 *Claims against the estate.*—The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, * * *. Only claims enforceable against the decedent's estate may be deducted. If the claim is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. * * * "

Measured by the criteria of the statute and the regulation, which adds the additional requirement that the claims be personal obligations, we hold that the debts and expenses here were deductible in full from the community interest of decedent, and reverse to that extent.

First, the Texas case law makes it abundantly clear that decedent by the terms of his will could so obligate his estate and his community property. *Medlin* v. *Medlin*, Tex. Civ. App., 1947, 203 S.W. 635; and *Matthews* v. *Jones*, Tex. Civ. App., 1952, 245 S.W. 2d 974. It is true that neither of these cases involved taxes, but the regulation here requires only that the payment be authorized under the Texas law. Cf. *In re Marino's Estate*, Cal. Dist. Ct. App., 1940, 102 P. 2d 443.

Second, the government contends that only one-half of the debts represented personal obligations of the decedent and for that reason only one-half may be claimed as deductible. Cf. *Lang's Estate*, supra. This, too, is a question of state law. The general rule is that on dissolution of the community the husband, but not the wife is personally liable for community debts. 31 C.J.S., Husband and Wife, § 566b(1), p. 100. This is the law of Texas. A judgment could have been obtained against the estate of decedent for the full amount of the community debts. Of course, the community of the wife under Texas law is liable for payment of the community debts, and her husband could recover from it for advances made to pay community debts, but no personal judgment could be obtained against her for community debts. The surviving wife does not personally owe the community debts. *Leatherwood* v. *Arnold*, 1886, 66 Tex. 414, 1 S.W. 173; *Security Nat. Bank of Wichita Falls* v. *Allen*, Tex. Civ. App., 1924, 261 S.W. 1057, *Sargeant* v. *Sargeant*, Comm. of App., 1929, 118 Tex. 343, 15 S.W. 2d 581;

and *Anderson* v. *Bundick*, Tex. Civ. App., 1952, 245 S.W. 2d 318. The debts were personal to decedent and to him only under the Texas law. The fact that the community property or even his property was sufficient to pay the debts does not take them out of the personal category.

Third, it is contended that there was no full and adequate consideration for more than one-half of the debts. The statute itself was amended in 1932 to make it clear that this requirement applies only where the debt is founded upon a promise or agreement,* and thus we do not reach the question of consideration for the debts here were in the main for income taxes and ad valorem taxes, debts imposed by law. The contention of the government would be well taken if the debts were founded on contract; otherwise a deduction could be claimed against the estate of decedent for a debt where one-half of the consideration received under the debt, such as the proceeds of a loan, went into the estate of the surviving wife. Here, however, no effort has been made to segregate the debts as between being founded on contract or imposed by law and none are pointed out as arising under contract.

The direction in the will of decedent, and the Texas law, coupled with the provisions of the Revenue Statute and Regulation, make it clear that the total of the debts and expenses of administration as specified in the findings of fact by the District Court were deductible from the gross estate of decedent. The District Court erred in not so holding. Cf. *Estate of Lucy O. McGugan v. Commissioner of Internal Revenue*, 1942,

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*Senate Report No. 665, 72nd Congress, 1st Sess., p. 51 explains the amendment (§ 803 of the 1932 Act) as limiting the requirement for consideration to liabilities founded on contract, as distinguished from liabilities imposed by law or arising out of torts.

47 B.T.A. 658 where the expenses of last illness and funeral expenses were allowed as a deduction from the gross estate of the wife, although these expenses were the primary liability of the husband under Florida law, where the wife provided by her will for payment out of her estate. See also *Estate v. Sarah H. Bradley v. Commissioner,* Memorandum opinion, Docket No. 106452, 1943, CCH, 2 TCM 609 involving a Georgia estate to the same effect.

We affirm that part of the judgment holding that the devise to the widow of one-third of the separate property of decedent and the one-half interest in the community automobile qualified as a part of the marital deduction or exclusion from the estate of decedent.*

Certain basic facts must be borne in mind in considering this question. There was no exchange of property between the testator and Mrs. Stapf, and she did give to the testamentary trust set up by decedent more than she received under the will. Only decedent's one-half interest in the community property is includible in his gross estate for federal tax purposes, *Commissioner of Internal Revenue v. Chase Manhattan Bank,* 5 Cir., 1938, 259 F. 2d 231, and there is no contention that the property of the widow passing by the election under the will of decedent became a part of his gross estate for estate tax purposes. And,

* The Commissioner allowed the one-half community interest of the husband in the automobile as a part of the marital deduction. No issue was raised to such allowance by the government in the trial court where the allowance was affirmed. Now it is asserted that the Commissioner was in error in the allowance which was based on his belief that Mrs. Stapf would have received the automobile whether she elected to take under the will or not. While this belief of the Commissioner was incorrect because the devise of the automobile was also based on the election, under our decision we do not reach this question.

lastly, under the Texas law the devise of one-third of the whole community to the widow did not pass to her under the will but was satisfied out of her own one-half. *Jones* v. *State*, Tex. Comm. App., 1928, 5 S.W. 2d 973; and *Calvert, Comptroller v. Fort Worth National Bank*, Tex. Sup. Ct., 1962, 356 S.W. 2d 919.

The statute here in question, par. (e)(ii) of § 812(e)(1); supra, having to do with the valuation of marital deduction property passing from a decedent to his surviving spouse is as follows:

> "(E) *Valuation of Interest Passing to Surviving Spouse.*—In determining for the purposes of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—
>
> "(ii) where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such incumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."

The government relies on Treasury Regulation 105, (1939 Code), § 81.47c(b), which extends the language of this statute to include an election as here, specifying by example that in computing the marital deduction the value of the bequest to a widow is to be reduced by the value of the community property interest relinquished by her. Neither this section of the Act or its legislative history envision such an example or result.* The regulation in this regard changes the plain terms of the statute by sweeping

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*Senate Supp. Report No. 1013, Part 2, 80th Cong., 2nd Sess.; House Report No. 1274, 80th Cong., 2nd Sess.

away the last clause thereof and must give way to the statute. *Kosland* v. *Helvering*, 1936, 298 U.S. 441, 56 S. Ct. 767, 80 L. Ed. 1268; *Miller v. Commissioner of Internal Revenue*, 5 Cir., 1956, 237 F. 2d 830.

We also put aside the contention of the taxpayer that an encumbrance or obligation to be taken into account in valuing the property to be excluded means an encumbrance or obligation on the property such as a lien against the property for a debt, as distinguished from an obligation or encumbrance in the nature of a condition as here under the election. *Wachovia Bank & Trust Co. v. United States*, Ct. Cl. 1958, 163 F. Supp. 832.

We look to the terms of the statute itself for its meaning. The last clause of it teaches how the valuation is to be computed and this is the key to the determination of this issue. It shall be taken into account in the same manner as if the amount of a gift of such interest by the husband to his wife was being determined.

The value of a gift by a husband to a wife of property, on the condition that she surrender to, or give for the benefit of a third party a portion of her property, would not be reduced or "netted" by the amount of property given up by the wife. There must be a monetary consideration or like benefit to the original donor before the value of the property surrender is to be deducted from the value of the gift. *Commissioner of Internal Revenue v. Wymyss*, 1945, 324 U.S. 303, 65 S. Ct. 652, 89 L. Ed. 958; *Commissioner v. Bristol*, 1 Cir., 1941, 121 F. 2d 129; and *Estate of Koert Bartman*, 1948, 10 T.C. 1073. All that Mrs. Stapf did by her election was to take the property devised to her and in turn surrender part of her property to the trust for the benefit of her children. Within gift tax confines the commu-

nity property of the widow passing under the will of the husband to others may not be "netted" against the devise to the widow, and thus testator, were the transfer inter vivos, would be liable for gift taxes on the full value of the devise.[1] Viewed in this light the devise of the one-half interest in the automobile and the one-third interest in the separate property of the testator qualify as a part of the marital deduction and the District Court did not err in so holding.

The gift and estate tax statutes complement each other. Here estate taxes are due now on the property of the husband with the devise to the widow excluded. It is a part of the marital deduction or exclusion on which taxes are deferred to the estate of the widow to be assessed on so much of it as survives on another day. The net of the transfer by the widow became subject to gift taxes at the time of the transfer. The property transferred by the widow will, to the extent of an amount equal to the devise to her, escape both gift and estate taxes. Nevertheless, and this applies alike to our holding on the deductibility of the debts and expenses of administration here, it is something permitted by the statute and proscription, if indicated, is for the Congress.[2]

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[1] *Aliter* on the transfer by the widow. The devise would be "netted" against what she surrendered as she did receive consideration of the necessary type. *Commissioner v. Seigel*, 9 Cir., 1957, 250 F. 2d 339; *Commissioner v. Chase Manhattan Bank*, supra; and *Turman v. Commissioner of Internal Revenue*, supra.

[2] On the subject of a windfall under another tax statute, it has been aptly said:

"Granting the government's proposition that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the congressional thumb, not the court's." *Fabreeka Products Co. v. Commissioner*, 1 Cir., 294 F. 2d 876,

Having reversed in part and affirmed in part we REMAND for such other and further proceedings as may be necessary and which are not inconsistent herewith.

WISDOM, *Circuit Judge*, dissenting:

I respectfully dissent.

With deference, I feel compelled to say that, in my opinion, the result reached by the majority is repugnant to fundamental principles of community property law. Nothing in Texas law requires the holding. Nothing in tax law requires it. And, the decision is inconsistent with the purposes of the equalization provisions of the Revenue Act of 1948 which put an end to the tax War-Between-the-States.

I.

Testamentary Instructions to Pay Community Debts and Administration Expenses.

A. The Will

This case stands alone. As far as I have been able to discover, no one, in Texas or in any other traditional community property state, ever before dreamt up the notion that by instructing his executors to pay the community debts from his share of the community a testator could:

> (1) double the federal estate tax deduction for his half of the debts of the community and
>
> (2) correspondingly increase his widow's share of the community which, as her share by vested right, is not includible in his taxable estate.

879, cited in *The Hanover Bank, Extr.* v. *Commissioner*, No. 224, Supreme Court, October Term, 1961, decided May 21, 1962, 30 L.W. 4385, — U.S. —, — S. Ct. —, —, — L. Ed. 2d —.

This notion is so contrary to one's ingrained understanding of the community as a partnership, I question whether Stapf's will did indeed intend the executors to take the extreme position they have taken. The will does not, in terms, require it.

The will does make plain the testator's intention that the debts and charges against the community should be payable from his share of the community or from his separate property. This is a testamentary provision common in a community property state. "There is no doubt", as Judge Dooley, the district judge below, remarked, "that a testator may lawfully exercise selectivity among different portions or different devises and bequests of his estate and order an impact of liabilities resulting in disproportionate burdens, or even a total burden on the one hand and exoneration on the other, and that is true in respect of payment of taxes, even the Federal Estate Tax." 189 F. Supp. 830, 834. Usually, "the intention of testator [is] to give his wife her interest in the community estate free from all claims of debts so far as the other legatees [are] concerned." *Redelsheimer v. Zepin*, 1919, 105 Wash. 199, 177 p. 736. See also *In re Hart's Estate*, 1929, 150 Wash. 482, 273 p. 735.* "This would allow of the division or partition of the community property between the surviving spouse and the heirs of the deceased spouse before debiting against such property the community property debts, so that the share going to the surviving spouse would go free of any liability for the community debt." 1 DeFuniak, Principles of Community Property Law, § 211 (1943). The Texas cases cited in the majority opinion are to the same effect. *Medlin v. Medlin*, Tex. Civ. App.,

* Both cases are cited in Lang's Estate v. Commissioner, 9 Cir., 1938, 97 F. 2d 867.

1947, 203 S.W. 2d 635; *Mathews v. Jones*, Tex. Civ. App., 1952, 245 S.W. 2d 974. In such cases, the dispute is only over the construction of the will. There is no holding and no intimation in these decisions that the purpose or effect of a will such as Stapf's is to enable executors to take a tax deduction for paying the debts chargeable by law to the wife's share of the community.

A simple, reasonable construction of the will is that Stapf's purpose was to make the inducements so attractive Mrs. Stapf would feel duty bound to take under the will. Should she resist the will, her share of the expenses and debts would be payable from her half of the community. The legal effect of the pertinent testamentary language is to make a conditional gift or legacy to the widow in an amount equal to half of the charges against the community. The bequest is at the expense of the other distributees and effects a redistribution of the decedent's estate. But it is no different from instructions to the executors to pay the mortgage on a son's house, or to pay the debts of a third person. It is a straight pecuniary legacy.

B. Texas Law

The basic error of the majority lies in their not recognizing that in the settlement of the community, following its dissolution, the community is regarded as a third person, vis-a-vis husband and wife. It is not a civil person in the common law sense, but time and again courts have referred to it as a separate entity. "[T]he laws of Washington establish a community between spouses which is a separate entity, 'just as a corporation or an association'."[10] More often, the

[10] Lang's Estate v. Commissioner, 1938, 304 U.S. 264, 58 S. Ct. 880, 77 L. Ed. 1066.

community is described as a partnership. In a very early case the California Court said:

> "Our whole system, by which the rights of property between the husband and wife are regulated and determined is borrowed from the civil law and Spanish law. . . . The relation of husband and wife is regarded by the civil law as a species of partnership, the property of which, like that of any other partnership is primarily liable for the payment of its debts." *Packard* v. *Arellanes*, 1861, 17 Cal. 531, 537.

In Texas the community is sometimes referred to as a "trust," but "there is nothing in such a 'theory' that conflicts with the view of a marital partnership, a term frequently used by the Texas Courts, since it is merely designed to make clear that fiduciary obligations are imposed upon the one holding the legal title, the same fiduciary obligations which are imposed on any partner who has control and management of partnership assets." 1 DeFuniak, Principles of Community Property § 95 (1943). In an authoritative discussion of Texas community property law,[11] Judge Hannah described the community:

> "The relationship of the spouses in Texas during their life time is substantially that of partners in a commercial partnership, and the husband and wife are in all respects equal partners, the husband being the managing partner and vested with management powers."

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[11] Rompel v. United States, S.D. Tex., 1945, 59 F. Supp. 483, *rev'd* United States v. Rompel (Herbst), 1945, 326 U.S. 367, 66 S. Ct. 191, 90 L. Ed. 137. This is the Texas companion case to the Louisiana case of Wiener v. Fernandez, E.D. La., 1945, 60 F. Supp. 169; *rev'd* Fernandez v. Wiener, 1945, 326 U.S. 340, 66 S. Ct. 178, 90 L. Ed. 116 upholding the constitutionality of the Revenue Act of 1942.

As DeFuniak comments, "It is difficult to see how it can be observed in any other light, for it represents the right to share equally in acquets and gains of the spouses during the marriage as well as liability for the obligations incurred on behalf of the community, usual attributes of partnership." 1 DeFuniak, Principles of Community Property, § 95.

In keeping with the view that the community is regarded as a partnership separate from the partners, Texas law provides that the community property of husband and wife "shall be liable for their debts contracted during marriage." Art. 4620, Vernon's Ann. Tex. Civ. Stat. And, Section 156 of the Texas Probate Code, provides:

> "Community property, except such as is exempt from forced sale, shall be charged with all valid and enforcible debts existing at the time of the dissolution of marriage by death."

No individual has the testamentary power to change this law of Texas. In every case the community passes with the debts of the community charged against it. Tex. Prob. Code §§ 45, 1516.

Death dissolves the community. Then, as in the dissolution of a partnership, there is in equitable accounting between the separate estates of husband and wife and the community. See 30 Tex. Jur. 2d, Husband and Wife, § 134 and cases there cited. The personal liability of the husband provides no basis for shifting to him all of the community debts, even if he has paid the debts from his separate funds. "The rule is settled that the separate estate of one spouse must be reimbursed by the community estate for advances from such separate estate." *Snodgrass v. Robertson*, Tex. Civ. App., 167 S.W. 2d 534, err, ref. W.O.M. Even when a husband is sued and held liable on a community debt, the wife's share of the

community is not relieved of liability. "It is well settled in [Texas] that even though the wife is not named as a party to an action by or against the husband concerning the community property, she is still bound by a judgment rendered against the husband in the action. This rule is based on the doctrine of virtual representation under which the husband is by law, designated the representative of the wife's interests in the community." 30 Tex. Jur. 2d., Husband and Wife, § 167.

The husband's personal liability, on which the majority relies as the principal basis for their decision, does not reduce the community's liability. It does not affect the liability of the widow's share for half the debts. It does not increase the amount (one-half) of the claims against the husband's estate when the community is sufficient to satisfy the claims. Thus:

> "Under our law the community property is the primary fund for the payment of community debts, and we think that where there exists sufficient community property to pay the community debts, no resort can be had to the separate property of the deceased husband for the purpose of paying such debts, though such property is, of course, liable if the community property should prove to be insufficient." *Clark v. First Nat. Bank,* Com. App. Tex., 1919, 210 S.W. 677, 679.

In short, the personal liability of a husband is that of a surety. If a husband pays community debts out of his separate estate, the community reimburses the separate estate on dissolution of the community. The wife is a special partner in a limited partnership since her liability is limited to her share of the partnership assets. The general partner's (the husband's) liability is unlimited because it is he who has the control and administration of the partnership. But the

husband's unlimited liability for community debts and the wife's limited liability for such debts are no more determinative of their respective rights and liabilities as owners of the community, than are the corresponding liabilities of a general partner and the special partner in a commercial partnership in the common law in determining their respective property rights and liabilities. The fact that only the husband may be sued does not relieve the wife's share of any liability; it is really the community that is sued and must pay the claim to the extent of the community estate.

This brings us to the question of the effect of Stapf's will under Texas law. Texas law is clear beyond a doubt: if there had been no will, since the community was able to pay its debts only half of the debts would be allowed against Stapf's estate. Should the will make a difference? No. The wife's share was charged with half the debts before Stapf's death. His death dissolved the community, making it impossible for Stapf to change the status of claims fixed prior to his death. The only change the will could make would be by providing a method for payment of debts. But a testamentary direction to executors to make a payment from the decedent's estate, to the benefit of another, is simply a legacy.

If the reasoning of the majority were sound, logically Stapf's will should not affect the majority's conclusion. Their decision rests on the husband's personal liability for the community's obligations. But that liability exists without a will. It is completely independent of a will. Whether or not a husband is personally liable, when the community is dissolved Texas law divides the liabilities as it divides the assets.

C. Tax Law

1. *The "Claim" contemplated.* Section 812(b)(3), Internal Revenue Code of 1939, permits the deduction of such "claims against the estate as are allowed by the laws of the jurisdiction under which the estate is being administered." The state law does not apply of its own force. The federal tax law, for its own purposes, incorporates state law by reference. See Hart and Wechsler, The Federal Courts and the Federal System, p. 456; cf. *Towner v. Commissioner*, 182 F. 2d 903, 907 (2d Cir., 1950). The role played by state law in the taxing statute is explained by the Supreme Court in *Morgan v. Commissioner*, 309 U.S. 78, 80 (1940):

> "State law creates legal interests and rights. The federal revenue acts designate what interests or rights so created, shall be taxed. Our duty is to ascertain the meaning of the words used to specify the thing taxed. If it is found in a given case that an interest or right created by local law was the object intended to be taxed, the federal law must prevail no matter what name is given to the interest or right by state law."

A similar principle should be applied in allowing or disallowing a claim under § 812(b)(3). The question to ask is whether a claim is the type of claim against the estate contemplated by the taxing statute.

The type of claim allowable as a deduction in determining the amount of a decedent's estate cannot be a claim based solely on the husband's personal liability for community debts. That is only a potential liability to creditors *which is washed out in this case* since the community property was sufficient to satisfy the debts of the community; claims against a solvent community after dissolution of the partnership are not against the decedent personally but are attrib-

utable to the marital estate. In the accounting between the separate estates of husband and wife and the community, the husband's liability would be for only half the claims. "Regardless of the incidents of the husband's personal liability for community debts during his life time . . . community debts [are] satisfied pro rata from that portion of the community property distributable to the wife and that portion subject to the husband's testamentary disposition." *Lang's Estate v. Commissioner,* 9 Cir., 1938, 97 F. 2d 867. This puts the tax where it naturally falls, on half of the net community—the only part over which Lowell Stapf had testamentary control.

The salient feature of a true "claim" is its involuntary nature. The debtor owes the claimant money and the claimant has a right to payment irrespective of the debtor's wishes. In this case the claim is provable against the testator's estate only because of the decedent's voluntary and gratuitous testamentary assumption of the claim. In *United States* v. *Mitchell,* 7 Cir., 1934, 74 F. 2d 571, the Seventh Circuit, in discussing whether an obligation, voidable under the Statute of Frauds, could be deducted if the executors had waived the defense and paid the claim, stated: "Nor can an asserted obligation which was enforceable only at the option of the deceased obligor be deducted."

2. *Authorities.* Neither *First-Mechanics Nat'l Bank* v. *Commissioner,* 3 Cir., 1940, 117 F. 2d 127, nor *Lang's Estate* v. *Commissioner,* 9 Cir., 1938, 97 F. 2d 867, relied on by the majority, supports the Court's holding. Each, especially *Lang's Estate,* points the other way. In *First-Mechanics* the court refused to allow as a deduction debts voluntarily paid by the estate and approved by the state orphan's court. It concluded that since the estate was not obligated to

pay the claim, the claim was not deductible. In *Lang's Estate,* as in this case, the taxpayers argued that under the law of the State of Washington, since "a husband is liable for community debts as fully as the community," the "entire amount of these community debts should be deducted from the gross estate." The court repudiated this contention:

> "Regardless of the incidents of the husband's personal liability for community debts during his lifetime, section 1342, Remington's Revised Statutes, supra, as construed by the Supreme Court of Washington, requires that community debts be satisfied pro rata from that portion of the community property distributable to the wife and that portion subject to the husband's testamentary disposition. It is only by provision of a deceased husband's will that a community debt may be charged solely against his share of the community." *Redelsheimer v. Zepin,* 105 Wash. 199, 202, 177 P. 736; *In re Hart's Estate,* 150 Wash. 482, 492, 273 P. 735. "If there be sufficient community property in the estate to discharge the obligations here in issue, then no more than one-half can be termed personal obligations of the decedent." *Lang's Estate v. Commissioner,* 9 Cir., 1938, 97 F. 2d 867, 871, 872.

In the next to last sentence of the quotation, on which the majority rely heavily, all that the court was saying was that Lang's will had not provided for payment of community debts out of his share; as a matter of *property law,* the claims were not provable against Lang's estate. The Ninth Circuit's citation of *Redelsheimer v. Zepin* and *In re Hart's Estate* makes this plain. Neither of these cases had anything to do with taxes; they turned on whether the testator intended burdening his share of the community with payment of all of the debts. Thus, *Redelsheimer v.*

Zepin, holds that the testator intended "to give his wife her interest in the community estate free from all claims of debts *so far as the other legatees are concerned.*" In *Hart's Estate* the court held that the testator intended "all debts should be paid first from the decedent's property, thus passing to the appellant her community interest in the estate free and clear of all of the community indebtedness." Of course, in the absence of a claim provable against the estate, as a matter of property law the question facing this Court did not arise.

All of the tax authorities agree that where, "under local law, a claim is both an obligation of the community as well as a personal liability of the deceased husband, and it must be satisfied pro rata out of both shares to the extent that there are sufficient funds, no more than one-half is a 'personal obligation' of the decedent and hence only one-half is deductible." Mertens' Law of Federal Gift and Estate Taxation" § 26.20. See also Jackson, Community Property and Federal Taxes, 12 S.W.L. Jour. 43 (1958); Childress, Community Property in Administration of Estates in Texas, Tex. Inst., 5th Ann. Tax. Conf. (1957), 155, 167; Warren and Surrey, Federal Estate and Gift Taxation (1961), p. 710; Lowndes and Kramer, Federal Estate and Gift Taxes (1962), § 15.18, p. 347.

The executors find support for their position in two tax court cases dealing with funeral expenses: *Estate of McGargan*, 47 B.T.A. (1942) and *Estate of Bradley*, 12 P-H Tax Ct. Mem. 1195, CCH 2 TCM 609 (1943). These were Florida and Georgia cases; they did not involve community property. Besides, Stapf's funeral expenses are not at issue here; they were allowed as a full deduction. There is little or no analysis of the rationale for allowing the deduc-

tion in either case, other than the statement in *Estate of Bradley* that since the sums were actually expended by the executors and approved by the state court having jurisdiction, they were deductible. Such a statement is clearly incorrect. In *Fidelity-Philadelphia Trust Co. v. United States*, 3 Cir., 1955, 222 F. 2d 379, the Third Circuit held that executors' commissions were properly deductible only up to three per cent of the gross estate, even though the state orphans' court had allowed four per cent. "The fact that a claim was presented and allowed in the probate court and subsequently paid by the executors has no bearing on the deductibility of the claim in question [in computing the net taxable estate]." *United States v. Mitchell*, 7 Cir., 1934, 74 F. 2d 571, 573; see *Estate of Schoenfeld*, 37 B.T.A. 36, 40 (1938).

The principles applicable to allowance of funeral expenses are completely inapplicable to allowance of debts or claims against the community. A claim for funeral expenses comes into existence *after* dissolution of the community. In *Blair v. Stewart*, 5 Cir., 1931, 49 F. 2d 257; *cert. den.* 1931, 284 U.S. 658, 52 S. Ct. 36, 76 L. Ed. 558, this Court, construing Texas law, held that funeral expenses chargeable against "the estate" were chargeable against the only estate being administered, "the interest of the decedent in community property." Since that case, "it has been the uniform practice of examining revenue agents in Texas to allow all of the decedent's funeral expenses . . . . as a deduction against the decedent's half of the community." [12] However, both courts and legislatures have stretched community property law in dealing with funeral expenses. Texas courts take

[12] Childress, Community Property in Administration of Estates in Texas, Tex. Inst, 5th Ann. Tax Con. 155, 177 (1957).

the view that "a decent regard for the memory of the dead" warrants holding the community liable for funeral charges, and have expressly disapproved of *Blair v. Stewart*. *Norwood v. Farmers & Merchants National Bank of Abilene*, Tex. Com. App. 145 S.W. 2d 1100, 1103, *err. ref'd*; see also *Goldberg v. Zellner*, Tex. Com. App. 261 S.W. 801; *Richardson v. McCloskey*, Tex. Com. App. 276 S.W. 680; *Hocker v. Piper*, Tex. Civ. App. 2 S.W. 977; *Goggins v. Simmons*, Tex. Civ. App. 1958, 319 S.W. 2d 442.

3. *Tax Effects.* The subject of the federal estate tax is the transfer of economic interests. A decedent's assumption of the debts of another cannot change the total of the economic interests transferred. It can only divert part of the total by a legacy equal to the debts assumed.

Under the majority's holding, the rich and shrewd in a community property state can put the estate tax out of business. For example, in the twilight of their years, a couple with community property worth $1,000,000 could borrow an additional $1,000,000 and invest it in securities, using the $2,000,00 as collateral. As a result, the community property would be increased from one million to two million dollars, and would have debts against it of one million dollars. If the husband provided by will that all community debts be paid out of his share of the community property, upon his death his share of the community property would be worth $1,000,000. All of this, however, would be matched by deductible community debts. Thus, under the Court's holding, the entire "net" estate of $1,000,000 would pass, untaxed, to the wife.

If the majority decision is not corrected, the will of every informed taxpayer in all the community property states is certain to follow Stapf's will. Such taxpayers will enjoy a substantial advantage over tax-

payers in common law states. With the same amount of property as that of a married couple in a common law state, a Texas widow's share of the community will be larger than the marital deduction, to the extent of one-half of the debts. Judge Dooley pointed this out clearly, 189 F. Supp. 830, 834:

> "To say that a will with such provisions is effective under the law of Texas is not at all the same thing as saying that under the laws of the State of Texas, dealing with the allowance of claims in the course of probate and administration or in levying the state inheritance tax, the law puts the power in the hands of a testator at will to alter the amount of deductible debt obligations up or down, depending on whether the testator chooses to assume separately all of the community debts or prefers to let the survivor of the marital community bear one-half of such liability. The Federal Estate Tax Law was revised and altered materially in 1948 with the purpose of achieving approximate equality among taxpayers in community and non-community states. It is not readily apparent how a testator in a non-community state could very well duplicate the advantage sought in behalf of the present estate."

D. Costs of Administration

The majority opinion does not differentiate between funeral expenses, administration expenses, and debts. Each of these, however, is a distinct category controlled by its own rationale in the determination whether it is chargeable to the decedent's estate or to the community. They cannot be lumped together. The official Interpretative Commentary to Section 322 of the Texas Probate Code, for example, states that funeral expenses, expenses of administration, and expenses incurred in the preservation, safekeeping, and management of the estate "are not debts of the dece-

dent". As pointed out in this opinion, notwithstanding *Blair v. Stewart,* supra, Texas courts treat funeral expenses as charges against the community.

If the husband should die first, half of the costs of administration are charged against his estate, because the entire community is included within the administration.[13] *Katherine Schumacher,* 8 T.C. 453 (1947). If the wife should die first, all of the expenses of administration are deductible because only her half of the community is administered in her estate. *Blackburn's Estate v. Commissioner,* 5 Cir., 1950, 180 F. 2d 952.

The district judge, as I see it, properly allocated 70 per cent of the expenses of the administration to the community, that is, 35 per cent to the widow's share and the 35 per cent plus the remainder of 30 percent to the decedent.[14] This seems a fair allocation. As

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[13] DeFuniak explains the reason for this:

"The fact that where the husband dies the administration of the community property should be separate and apart from, although inside, the administration of the husband's estate which is taking place, seems not always to be understood. It must also be remembered that, although such an administration of the community property is taking place in order to pay community debts and accomplish a partition, half of the community property so being administered belongs not to the deceased husband but to the surviving wife, and always belonged to her from the moment of its acquisition during the marriage . . . . [A]dministration of community property is a thing apart from ordinary administration, in that it is actually settling up matters relating to property which belongs in equal shares to the decedent's estate and to a living person and not merely the administration of property belonging entirely to the decedent's estate." 1 DeFuniak, Principles of Community Property, Dissolution of Marital Community, § 205, p. 585, 586.

[14] Perhaps a better rule would be to fairly apportion these expenses between the estate and the surviving spouse on the basis of the time and effort expended on behalf of each estate. The services of the executor, the attorneys and accountants in seeing

noted by Judge Dooley, the executors spent a great amount of their time in connection with the administration of the community. There is no good reason for giving Mrs. Stapf a free ride.

E. Conclusion

Strong economic, social, and moral reasons support the view that marriage is a full partnership between equal partners. Judge Dooley speaks for all of the traditional community states when he says, there is "a deep-rooted tradition . . . that liabilities against the whole community estate should be borne half and half, in the true spirt of the marital partnership." 189 F. Supp. 830, 835.

It is not easy to fit community property concepts smoothly into a tax system essentially derived from principles extracted from some sort of a "brooding omnipresence in the sky." As a consequence, for many years the integrity of the community property system as an institution was under almost continuous attack from taxpayers understandably resentful that citizens in common law states should pay higher federal taxes than citizens in other states. The attack reached its peak in the Revenue Act of 1942. This statute, ignoring the wife's vested ownership in community property and community earnings, treated her half as owned by the husband. The Act required the inclusion of the whole community in the taxable estate of the first spouse to die. The statute may have been motivated by ideals of tax equality and uniformity, it may have been grounded on sound tax arithmetic, but

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that the debts are paid and in getting half of the community into the hands of the surviving spouse are of benefit to the survivor's estate and some portion of these expenses may be equitably chargeable to such survivor." Jackson, Community Property and Federal Taxes, 12 S.W.L.J. 1, 37 (1958).

it struck a severe blow against what many persons regard as an enlightened concept of the marital relationship and the status of married women. Finally, in the tax equalization provisions of the Revenue Act of 1948, after years of negotiation, a delicate but balanced reconciliation of interests was achieved by putting taxpayers in the common law states on the same paying basis as taxpayers in community property states "without tinkering with the property law of the states."[15] There are some who condemn the 1948 Act as not consistent with federal emphasis on control as the chief criterion in taxing, and as having generated new inequalities.[16] But the Act has saving graces. It works. The tax inequalities it created are relatively minor. In common law states the Act's reliance on check-book equality prevents any pressure from being exerted to introduce an alien legal institution. And, in community property states federal tax laws now no

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[15] Beveridge's phrase. Beveridge, 2 Law of Federal Law of Estate Taxation 181 (1956).

[16] See Surrey, Federal Taxation of the Family—The Revenue Act of 1948, 61 Harv. L. Rev. 1097 (1948); Anderson, The Marital Deduction and Equalization under the Federal Estate and Gift Taxes Between Common Law and Community Property States, 54 Mich. L. Rev. 1087 (1956). DeWind, The Approaching Crisis in Federal Estate and Gift Taxation, 38 Cal. L. Rev. 79 (1950). See also Memorandum Submitted by the Secretary of Treasury to the Senate Committee on Finance, March 1, 1948, Analysis of the Estate Gift Tax Provisions of H.R. 4790 (Revenue Act of 1948), reprinted in Warren and Surrey, Estate and Gift Taxation (1961). Lowndes and Kramer, Beveridge, and, not surprisingly, legal writers in the community states have found that after adoption of 1948 Act the sky did not fall. Beveridge, Law of Federal Estate Taxation, Chap. 14 (1956); Lowndes and Kramer, Chap. 17 (1962). See Thurman, Jackson, Riehm, Nossaman, and Ray, cited in notes 17 and 18. See also Golden, A Decade with the Marital Deduction, 97 Trusts and Estates, 304 (1958).

longer run counter to laws and customs long rooted in the civil law concept of the marital relationship as a partnership between husband and wife.[17]

This decision imperils the tax reconciliation between the States. The irony of it is that in the name of Texas and taxes, the holding egregiously offends Texas law and tax law.

II. The Marital Deduction.

The election device, borrowed from the common law and an anomaly in a community property system, enables a testator to exchange a marital bequest for the power to dispose of his widow's share of the community over which, by law, he has no testamentary control.[18] The usual transaction is three-cornered, since the widow's property passes not to or through the estate but to a trust. Here, as a result of his widow's election, Lowell Stapf *increased* the amount of the property he controlled in his will.

The purpose of the marital deduction is to give to taxpayers in common law states the same tax benefits from a marital bequest that a surviving spouse has from her share of the community. To round it out, taxpayers in community property states are allowed

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[17] See Thurman, Federal Estate and Gift Taxation of Community Property, 1 Ariz. L. Rev. 253 (1959); Jackson, Community Property and Federal Taxes, 12 S.W.L.J. 1 (1958). Riehm, The Impact of Community Property Law on Federal Taxation, 4 S.W.L.J. 161 (1950).

[18] For discussion of the Widow's Election and the Marital Deduction, see Ray, The Widow's Election—A Study in Three Parts, 15 S.W.L.J. 85 (1961); Westfall, Estate Planning and the Widow's Election, 71 Harv. L. Rev. 1269 (1958); Brown, The Widow's Election as a Tax Savings Device, 96 Trusts and Estates 30 (1957); Brookes, The Tax Consequences of Widows' Elections in Community Property States, U. So. Cal. 1951 Tax Inst. 83;. Nossaman, Trusts Under The Revenue Act of 1948, U. So. Cal. 1950 Tax Inst. 459.

a marital deduction up to one-half of the amount of the separate property.[10] The Act has two built-in requirements integral to a bequest qualifying as a marital deduction: (1) *There must be no strings.* The surviving spouse to whom the bequest is made must be given rights substantially equivalent to the absolute rights a surviving spouse has in her share of the community. This is the price the husband pays to obtain the marital deduction. (2) *The property bequeathed must be includible in the widow's taxable estate* or must be subject to a gift tax on its disposition by gift, that is, taxed again in the same generation. This is the price the widow pays to obtain the marital deduction. These requirements tend to offset a large loss of tax revenue, taking into consideration the frequency with which persons of means would otherwise avoid taxation of a widow's estate by means of a testamentary trust with the income for life to the widow and the remainder to others. The marital deduction was sold to Congress and bought by Congress on these representations. The purpose and rationale of the Act, therefore, override the language. This is no place to bow down before literalism.

Here, it is just not a fact that Mrs. Stapf had the

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[10] This is not a deduction for bequests of separate property, as such. Aside from the effect of community property on the computation of the maximum allowable marital deduction, there is no difference pertinent here between community property and separate property. Community property may qualify for the marital deduction. However, the amount of the decedent's interest in community property must be subtracted (along with deductions for administration expenses and claims against the estate) from his gross estate to arrive at an "adjusted gross estate". Section 812(e)(2)(B), Code of 1939. The marital deduction cannot exceed 50 per cent of this adjusted gross estate. Thus, the amount of the marital deduction is limited or determined by the amount of separate property.

same rights to the bequest that she had over her community property. A survivor's ownership of a half interest in community property is absolute, unburdened, vested from the moment of the community's acquisition of the property. On the other hand, here the marital bequest was conditional and burdened with the obligation of the widow's giving up more than she received. The testator failed to pay the price he is required to pay for a marital deduction; the string he attached enabled him to control equivalent property, so that for all practical purposes, the property was part of his disposable estate.

The surviving spouse also failed to pay the price tag Congress put on a marital deduction: The bequeath did not increase her taxable estate by the amount of the property bequeathed. On the contrary, her taxable estate was reduced, since the value of her interest in the community, which she relinquished, exceeded the value of the bequest. She received no economic benefit from the bequest—except the tax savings. Moreover, she owed no gift tax, because she surrendered more than she received.

After the dust settled, the economic result of this transaction was a gift by the testator of $106,268.18 to the trust, and a gift by the wife of $5,174.50 to the trust. There was, therefore, no gift *to the spouse*. This is fatal to the executors' contention. The marital deduction is concerned only with a gift to a spouse. The Act is concerned with the economics of the transaction, as is evident from the fact that in determining the value of a bequest, "where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent . . . such incumbrance or obligation shall be taken into account". When the dollar-effect is a minus $5,000 result for the widow, it

is unreal and obfuscatory to speak of the bequest as a gift to the spouse entitling the testator to a marital deduction.

The proper analytical approach, as I see it, is to recognize that we have a single three-cornered transaction involving the husband (H), the widow (W), and the trust (T).[20] The bequest and the election cannot be separated and treated independently; the testator himself made that impossible. An example will clarify the approach, taking round numbers and

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[20] The approach we take is in keeping with Commissioner v. Siegel, 9 Cir., 1957, 250 F. 2d 339, affirming 26 T.C. 743 (1956). In that case the decedent's estate consisted entirely of community property. The husband's will created a testamentary trust with his widow as income beneficiary and his son as remainderman, and put his widow to an election. The basic question was whether the value of the gift is reduced by the value of the property received by the donor from a third person. The court considered it all one transaction and permitted the reduction. The surrender by the widow of her community property rights, in effect, was a gift to the estate of the decedent to the extent that the value of the interest surrendered exceeded the value of the interest received. The Court spoke of the transaction as "a contract supported by adequate consideration" and treated it as part gift and part exchange. To the same effect, see Chase National Bank, 25 T.C. 617 (1955), decided on other grounds, sub. nom. Commissioner v. Chase Manhattan, 5 Cir., 1958, 259 F. 2d 231.

I would distinguish Helvering v. Butterworth, 1933, 290 U.S. 365, 54 S. Ct. 221, 78 L. Ed. 365, on the basis of the difference between the Pennsylvania widow's dower-rights which had no value prior to her husband's death, and the Texas widow's interest in community property, which belonged to her prior to her husband's death and could be surrendered as the price of acquiring an interest in property which she did not heretofore own. See Brooks, The Tax Consequences of Widows' Elections in Community Property States, U. So. Cal. 1951 Tax Inst., 83, 88.

changing the amounts so that they will be easy to follow. H dies, leaving $200,000 of separate property. The community amounts to $200,000. H's estate is $300,000; W's share of the community is $100,000. The will makes a bequest to W of $100,000 but puts her to an election requiring W to transfer her share of the community to T. W elects to take under the will, so her community interest of $100,000 goes to T. These are the economics: H has the same amount of property to dispose of as if he had made no bequest, $300,000, because of W's surrender of her property to H's testamentary control; W has the same amount of property, because the bequest of $100,000 is offset by the surrender of $100,000; T has $100,000 he did not have before. This is not my idea of the sort of a gift to a spouse that Congress had in mind when it enacted the marital deduction law.

Consider the tax effects, according to the majority holding. H would be entitled to a marital deduction of $100,000, bringing his estate down to $200,000. W owes no gift tax on the transfer to T, because the amount she transferred to T did not exceed the amount received. On W's death, there would be $100,000 only in her estate, if it were not consumed. Result, according to the majority: $100,000 escapes both estate and gift taxes. In 1948 the whisper of a rumor that the marital deduction might produce such a result would have torpedoed the Act.

In a common law state, the same result would be achieved only if the widow had property of her own. The scheme would have primary importance in a community property state because of the wife's ownership of half the community by operation of law. The majority's holding, therefore, tends to defeat the Act's purpose of placing all taxpayers on a par.

The result the majority reach is not dictated by the statute. Section 812(e)(1)(E) provides:

> "(E) *Valuation of Interest Passing to Surviving Spouse.*—In determining for the purpose of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—
>
> "(ii) where such interest or property is incumbered *in any manner*, or where the surviving spouse incurs *any obligation imposed by the decedent with respect to the passing of such interest*, such incumbrance or obligation *shall be taken into account* in the same manner as if the amount of a gift to such spouse of such interest were being determined."

If we give the italicized words a common sense meaning, we must take them to exclude the necessity that the obligation be a pecuniary obligation, such as a mortgage, attached directly to the property. "Any" incumbrance or obligation is broad enough to encompass the absolute obligation the decedent imposed here. See Ray, The Widow's Election, 15 S.W.L.J. 85, 141 (1961).

The Court subordinates the meaning of the section as a whole to a literal interpretation of "gift" in the final clause: the obligation shall be "taken into account in the same manner *as if* the amount of a *gift* to such spouse were being determined". But, as in any "as if" situation, the very use of those two little words is implicit recognition that the thing treated "as if" it were the same is not the same. Some allowance, therefore, must be made for the lack of sameness where, for example, it would be inconsistent with the purposes of the legislation to treat the bequest here exactly as a gift. A bequest cannot be treated for all purposes as a gift; it is a testamentary disposition and the estate tax is involved.

The majority start with the premise that a marital bequest must be given the identical tax treatment as a gift. They point then to the unquestioned fact that in determining the taxability of a gift, a condition that the donee transfer a portion of her property to a third person does not reduce the value of the gift. The consideration must benefit the donor to relieve a transfer by him from being a gift. *Commissioner v. Wemyss*, 1945, 324 U.S. 303, 65 S. Ct. 652, 89 L. Ed. 958. Since Mrs. Stapf's transfer went to the trust, not to her deceased husband, the majority hold that the value of the bequest was undiminished by the widow's election.

As pointed out, a view so literal defeats the purposes and rationale of the Act. On the other hand, if we bear in mind that in fact the bequest is a testamentary disposition, not an inter vivos transfer,—the donor is deceased—it is constructive and in keeping with the intent of the Act to regard the bequest as a gift. We may accept the principle that in determining the value of a gift, benefits flowing to the donor, not detriment to the donee, is decisive. Here, then, to the extent possible and in the only way benefits may flow to a testator, Stapf received full consideration for his marital bequest by Mrs. Stapf placing her property within his testamentary control.

Wemyss is no obstacle to this approach. In that case the husband made an ante-nuptial transfer to his wife to compensate her for the loss of income from a trust established by her first husband; on her remarriage the income was to go to her child. This was held to be a taxable gift. But the donor in Wemyss, unlike the donor here, received no offsetting consideration or benefits from the immediate donee. Looking at the economic effects of the tripartite transaction in Wemyss, the husband made a gift to his wife's

child, the income beneficiary of the trust. Wemyss, therefore, supports the argument I make here. In Wemyss, as in this case, because of the triangular nature of the transaction, the transferor made a taxable transfer that, in effect, was a gift to a third person, not to the spouse.

This brings us back to the dominant statutory intention to provide a tax deduction for a non-community property taxpayer making a gift to his surviving spouse equatable with the widow's half of the community. To the extent it is a gift to the spouse, after taking into account all obligations imposed by the decedent, it qualifies for the marital deduction. If, instead, the testator uses his widow as an interposed party to make a gift to a third person the transfer to the spouse cannot be regarded as a gift to her. Thus, Lowndes and Kramer take note of the district court's holding in the case before us but nonetheless say:

> "[W]hat the Regulations are driving at seems to be this. If a decedent bequeaths property to his wife in lieu of her interest in community property, which is not part of his estate and which does not pass to her from him, it seems clear that the only thing which the surviving spouse actually receives from the decedent is the excess of the interest bequeathed to her over and above the value of her interest in the community property. *Therefore, this should be the only amount which qualifies for the marital deduction*". Lowndes and Kramer, Federal Estate and Gift Taxes, § 17.5 (1962).

The statute does not refer to the effect of a widow's election. Moreover, the terms "incumbrance", "obligation", and "taken into account" are imprecise. See 4 Mertens, Federal Gift and Estate Taxation § 29.53 (1959). It is especially appropriate, therefore, for

Treasury to issue Regulations and for courts to give weight to the administrative interpretation of these terms.

Example (1) of Section 81.47c(b) of Treasury Regulations 105 is no different from the instant case.

> "(1) A decedent devised a residence valued at $25,000 to his wife, with a direction that she pay $5,000 to his sister. For the purpose of the marital deduction, the value of the property interest passing to the wife is only $20,000."

Example (3) of the Regulation provides for just such a contingency as has arisen here:

> "(3) A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife."

The Supreme Court has "many times declared that Treasury Regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons." *Commissioner v. South Texas Lumber Co.*, 1948, 333 U.S. 496, 501, 68 S. Ct. 695, 92 L. Ed. 836. I do not see any basis whatsoever on which the regulation governing marital deductions could be called "unreasonable and plainly inconsistent with the revenue statute".

I would hold that when a testator burdens a marital bequest with the condition that his widow surrender her property to his testamentary control the con-

dition is an "incumbrance" or "obligation" within the meaning of the Act. To the testator who is given power over property not otherwise within his testamentary control and to the spouse, the realities of the situation command recognition of the fact that the value of the bequest is the value of the property bequeathed over the value of the property surrendered by the surviving spouse. If the surviving spouse is worse off, this Greek-bearing-gifts bequest cannot qualify as a marital deduction, the justification for which is a no-strings spousal gift equivalent to the absolute ownership a surviving spouse has in the community.

I would AFFIRM the district court on the first point and REVERSE the district court on the second point.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Texas, and was argued by counsel;

On Consideration Whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed in part and reversed in part in accordance with the opinion of this Court; and that this cause be, and it is hereby, remanded to the said District Court for such other and further proceedings as may be necessary and which are not inconsistent with the opinion of this Court.

"Wisdom, Circuit Judge, Dissents."

September 26, 1962

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No. 54

In the

Supreme Court of the United States

OCTOBER TERM, 1963

UNITED STATES OF AMERICA,

Petitioner,

v.

DOROTHY ANNE STAPP AND B. T. WARE, II, EXECUTORS AND TRUSTEES OF THE ESTATE OF LOWELL H. STAPP, DECEASED, AND DOROTHY ANNE STAPP, INDIVIDUALLY,

Respondents.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

W. M. SUTTON,
P. O. Box 550,
Amarillo, Texas.
H. A. BERRY,
P. O. Box 550,
Amarillo, Texas.
JERRY F. LYONS,
P. O. Box 550,
Amarillo, Texas.
WINSTON R. SMITH,
P. O. Box 550,
Amarillo, Texas,
Attorneys for Respondents.

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No. 733

In the

Supreme Court of the United States

OCTOBER TERM, 1962

UNITED STATES OF AMERICA,
Petitioner,

v.

DOROTHY ANNE STAPF AND B. T. WARE, II,
EXECUTORS AND TRUSTEES OF THE ESTATE
OF LOWELL H. STAPF, DECEASED, AND
DOROTHY ANNE STAPF, INDIVIDUALLY,
Respondents.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Respondents, DOROTHY ANNE STAPF and B. T. WARE, II, Executors and Trustees of the Estate of Lowell H. Stapf, Deceased, and DOROTHY ANNE STAPF, individually, file this opposing brief in opposition to the petition of the United States of America, petitioner, for a writ of certiorari to review the judgment of the Court of Appeals in this case.

OPINIONS BELOW

The opinion of the District Court (R. 53-80) (R. will be hereafter used to refer to printed Transcript of Record filed in the Court of Appeals) is reported at *189 Fed. Supp. 830*, and is copied herein (App. 46a to 71a) (App. refers to the Appendix to this brief). The opinion of the Court of Appeals is now reported at *309 Fed. 2d 529* (App. 6a to 45a).

JURISDICTION

Respondents do not deny or question the jurisdiction of this Court as invoked by petitioner, but respondents submit that in the exercise of sound judicial discretion a writ of certiorari should be denied under Rule 19 of this Court.

QUESTIONS PRESENTED

Respondents submit that the first question presented in the petition is more accurately stated as below stated, but that the second question as presented in the petition and copied below is a fair statement of such question. Accordingly, respondents would state the questions presented as follows:

1. Should the agreed value of property passing to the surviving spouse under the will of the decedent and qualifying for the marital deduction be reduced to zero in determining the estate tax liability of the decedent's estate because the surviving spouse elected, as she was authorized to do under the decedent's will, to permit the passage to trustees of testamentary trust for the benefit of children of decedent, of an undivided interest in a part of her share

of the community property that was fully vested in her which was of a greater value than the property passing under the will to the surviving spouse?

2. Whether claims against the community estate for which the wife's half of community property is equally liable but which the decedent's will directs to be paid entirely from his half are deductible in full from the decedent's gross estate as "claims against the (decedent's) estate" within the meaning of § 812(b) of the Code.

STATUTES AND REGULATIONS INVOLVED

Sections 812(b) and 812(e) of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.), and §§ 81.36, 81.47a, and 81.47c of Treasury Regulations 105 are set forth in part in App. A, infra, pp. 1a to 5a.

STATEMENT

The brief statement in the petition, though modified as to actual figures for simplicity, is not an incorrect statement except to the extent that it is stated or implied that any portion of the community property, other than the decedent's ½ community fee in the family automobile, passed to the surviving spouse under decedent's will. Under the law of Texas, as recognized by the Court of Appeals and as is recognized in the petition (Note 6, page 5 of petition) the only portion of the decedent's estate that passed to the surviving spouse under the decedent's will was a ⅓rd interest in decedent's separate property (and a ½ community property interest in the automobile) valued at

$20,000.00. The total of $106,000.00 in assets held by the surviving spouse after her election consisted of the ⅓rd interest in decedent's separate property and his ½ community interest in the family automobile of the aggregate value of $20,000.00 and $86,000.00 of her share of the community property, which was satisfied out of the surviving spouse's ½ share of the total community estate already owned by her and which did not pass from the decedent to her.

REASONS FOR REFUSING THE WRIT

No claim is made by petitioner that the decision of the Court of Appeals is in conflict with the decision of another Court of Appeals or of this Court. In fact, no decisions from any Court are cited as being contrary to the decision below.

Petitioner attacks the decision of the Court of Appeals, primarily on the grounds, that if effect is given to the clear and express provisions of the Statutes here involved (Sections 812(b) and 812(e) of the Internal Revenue Code of 1939) as was done by the Court of Appeals, petitioner has fear that less taxation revenue, than that which petitioner thinks would be otherwise collected, would result. This, of itself, is not a proper basis for seeking relief here, nor does this contention by petitioner warrant or present grounds for this Court to construe a Statute, contrary to its terms, in order to prevent possible revenue loss. If changes in the Statutes of the character desired by petitioner are needed, then petitioner's request therefor should be presented to Congress and not here.

I. THE MARITAL DEDUCTION

The sole question presented with respect to the marital deduction issue is the application of Section 812(e)(1)(E)(ii) of the Internal Revenue Code of 1939 in valuing specific property passing absolutely to the surviving spouse and no one else, and clearly qualifying for the marital deduction.

The question of the liability, or the amount of liability, of the surviving spouse for gift taxes with respect to that portion of her community property ($25,000) passing from her to the Trustees for the children of the decedent and the surviving spouse, as a result of her election to take under the will, is not presented and has never been presented in this case.

Mrs. Stapf does not now and has never denied the gift tax consequences to her with respect to the passage of the 1/6th share of the community property (which came out of her ½ of the total community) to the trust as a result of her election to take under the will. This, however, is a separate transaction or occurrence from the passage of specific property to Mrs. Stapf under the decedent's will, and has tax consequences entirely separate from the issue here involved. A determination of the issue in dispute relating to the marital deduction would not determine the surviving spouse's gift tax liability, and whether she, the surviving spouse, would be entitled to "net" what she gave and what she received in determining such gift tax liability, which possibility is obviously the basis of petitioner's concern in

loss of possible revenue, is not presented for decision. Even if the Gift Statute permits such "netting", and a loss of revenue results, such fact would not justify or authorize a disregard of the clear and explicit provisions of the Estate Tax Statutes, including the marital deduction provisions, in determining the liability of the decedent's estate for estate taxes, as the Regulations and petitioner's contentions would do.

If petitioner's contention were to be sustained, the result would be to tax twice, for estate tax purposes, that which Congress, by the enactment of the marital deduction provision, has said should be taxed only once. This result would follow from refusing to exclude from decedent's estate, under the marital deduction provisions, the $20,000.00 of separate and community property of the decedent passing under decedent's will to his surviving spouse, thereby taxing such property in the decedent's estate and again taxing the same property in the estate of the surviving spouse upon her death. This fallacy in the contention of the petitioner was recognized by both the trial court and the Court of Appeals in their respective opinions as being contrary to both the intent and the express provisions of the marital deduction section.

The petitioner's contention, advanced under paragraph 1, pages 6, 7 and 8 of the petition, that ⅓rd of the decedent's separate property and his ½ interest in the community owned automobile (of a total value of $20,000.00), instead of passing to the surviving spouse, theoretically or imaginarily passed to the Trustees for the benefit of third par-

ties, is contrary to the provisions of the will, the actualities involved and the decision below.

The petitioner's incorrect construction of the Court of Appeals opinion on pages 7 and 8 of the petition is an unwarranted extension of the decision, and even goes far beyond all applications expressed as possible in the dissenting opinion. Contrary to the petitioner's assertion on page 7 of the petition, the decision below does not destroy the marital deduction or permit married persons to escape taxation entirely, regardless of the disposition of the estate, nor does the Court below hold that a testamentary gift to *anyone* may be made to qualify for the marital deduction by the simple device of having it "pass through" the surviving spouse. No such hypothetical situations, based on imagined facts, bearing no semblance of comparison to the present fact situation were presented for consideration and are far afield of any possible ambit of the decision below.

The imaginary example in footnote 9 on page 7 of the petition and the bold assertion on page 7 of the petition that the decision below could be used in non community property states even where the wife had no separate property in such an imagined situation to escape taxation, and the even bolder assertion that so long as there is a surviving wife the decedent can dispose of his property to whomever he pleases without giving anything to his wife and yet get the marital deduction, present fact situations not before the Court, and erroneous conclusions of petitioner not even recognized as being a possibility in the dissenting opinion. In fact, the fears of the dissenting opinion as to the possible

application of the majority opinion would not encompass such a result, for it was there pointed out that the possibilities of loss of taxation revenue as a result of the application of the majority opinion could occur in a common law state "only if the widow had property of her own", App. p. 39a. Additionally, it would appear that in the supposed situation, where the wife had no property of her own, and there was a direction that a payment or gift be made to a third party, such gift would have to be satisfied out of the property passing under the decedent's will and would be a direct charge thereon just as a lien against the property so passing would have to be satisfied out of the property. Such a situation is entirely different than the one here presented and no analogy or conclusion of the kind sought to be drawn by petitioner is proper.

The assertions in paragraph 2 on pages 8, 9 and 10 of the petition to the effect that the opinion below would sanction a testamentary bequest "passing through" the surviving spouse to a third party as qualifying for a marital deduction, or that a testamentary gift of property to someone other than the surviving wife could qualify, under the opinion below, as a marital deduction disregard the facts and misinterpret the holding below.

All the court below held was that $20,000.00 of property belonging to the husband (qualifying for the marital deduction because of his ownership of separate property of greater value) which passed absolutely to the surviving wife under his will was not to be reduced, under the explicit statutory language, to a negative value in determining the

estate tax liability and marital deduction exclusion in the husband's estate simply by virtue of the fact that the wife elected to take under the will and thereby relinquished a part of her community property ($25,000) to a testamentary trust created in the husband's will for the benefit of their children. The property that passed to the wife stopped there and would be subject to estate tax in her estate upon her death. Neither this property nor other property "passed through" the surviving spouse to third parties. Under the applicable law the decision of the court below and the facts there presented, the wife's 1/6th share of the community property, which went to trust for the children, was never a part of the deceased husband's estate and did not pass from him either directly to the children or from him "through" his surviving spouse to the children, as the petitioner would have this Court suppose by petitioner's argument and imaginary illustrations.

The correctness of the opinion below is demonstrated by an examination of the actual facts, the actual holding and the applicable established principles of law without resort to the exaggerated fears of loss of possible taxation revenue which loss, if any, would result solely from application of the Gift Tax Statute, not the testamentary disposition of property included in the decedent's estate, but to the gift of the separately owned share of community property of the surviving spouse, which was never a part of the decedent's estate, and which passed from her to the trust for the children as a result of her election to take under the will which privilege she separately exercised after the death of her husband.

Sections I (R. 12), IV (R. 13 and 14) and XII (R. 21-22) of the will of the decedent make it undeniably clear that the 1/3rd interest of the decedent in his separate property, and his 1/2 interest in the community owned automobile fully vested, without qualification, in the surviving spouse when she elected to take under the will.

Such property ($20,000) so passing to the surviving spouse will be taxed in her estate for estate tax purposes upon her death. Petitioner does not deny this or claim otherwise. Under such circumstances this property clearly qualified for the marital deduction, and the value of the property so passing is not to be reduced to a zero value simply because the surviving spouse effectively made a gift of $25,000.00 of her absolutely owned property to the trust. The property received by her under the will had a value of $20,000.00 in her hands, just as it had a value of $20,000.00 in the hands of the decedent before his death. *The value of the property passing to the surviving spouse did not change.*

Only the decedent's 1/2 part of community property is included in his estate for Federal estate tax purposes, and no part of the surviving spouse's 1/2 share of the community estate is includable in the estate of the first to die for estate tax purposes.

Commissioner of Internal Revenue v. Chase Manhattan Bank, 5th Cir. 1958, 259 Fed. 2d 231, cert. den. 359 U.S. 913;

Pitts v. Hamrick, 4th Cir. 1955, 228 Fed. 2d 486.

Petitioner does not deny this.

It is equally clear that by electing to take under the will the ½ community interest of the wife is not included in the gross estate of the husband for estate tax purposes, even though the wife's ½ community share, as well as the husband's ½ community share, was disposed of by the will of the husband. This is a long standing principle recognized by the Internal Revenue Service. Any question in this regard was removed in 1930 by the memorandum decision of the General Counsel of the Internal Revenue Service, to-wit: GCM 7773, CB IX-2, page 426, Ruling 33-4750, which refers to Section 302(a) of the Revenue Act of 1926, which is virtually identical, if not exactly identical, to the provisions of the Revenue Act in force at the time of the death of the decedent. The GCM was based upon two cases in the Northern District of Texas, namely, *Vincent v. United States*, and *Underwood v. Reed*. For convenience a copy of Cumulative Bulletin IX-2 reflecting such ruling is included in App. 71a to 72a of this brief. See also *Coffman-Dodson Bank & Trust Co., Executor, 40 B.T.A. 890*, and *The Pacific National Bank of Seattle, Executor, 40 B.T.A. 128*.

It is equally clear that under the established law in Texas, the ⅓rd interest in the total community property provided for Mrs. Stapf under the will did not pass to Mrs. Stapf under the will of Mr. Stapf, and did not become subject to state inheritance tax. This ⅓rd interest ($86,000.00) in community property, retained and owned by Mrs. Stapf after her election, just as it was owned before her election, is satisfied out of the ½ share of community property owned by Mrs. Stapf and *not* out of the decedent's share of the

community property. *Jones v. State, Tex. Comm. of App., 1928, 5 S.W. 2d 973*, and *Calvert, Comptroller, v. Fort Worth National Bank, Tex. Sup. Ct. 1962, 356 S.W. 2d 919, affirming Calvert v. Fort Worth National Bank, Tex. Civ. App., 348 S.W. 2d 19.* This is recognized by Petitioner, page 5, note 6, of petition.

As appears from the opinions of the trial court and the Court of Appeals, the petitioner erroneously contended in those courts that Mrs. Stapf received $106,000.00 under the will and gave up $111,000.00 by her election. All such prior contentions are now apparently abandoned by petitioner and it is recognized by petitioner, page 5 of petition, that only the $20,000.00 in property actually passed to the surviving spouse under the will of the decedent in line with the foregoing authorities and the decision of both the trial court and the Court of Appeals, thus the issue is confined to such $20,000.00 of separate property of the decedent (including the ½ community interest in the family automobile).

We are not here concerned with the requirements of Section 812(e)(1)(H) providing a limitation on the aggregate amount of the marital deduction, since the amount claimed as a deduction (including both the ⅓rd interest in decedent's separate property and his ½ community property interest in the family automobile) is less than 50% of the value of the "adjusted gross estate" as defined in the Statute.

The only controversy that has existed with respect to the marital deduction arises under Section 812(e)(1)(E)(ii) which relates to the valuation of the interest passing to the

surviving spouse. The petitioner would have the Court value the $20,000.00 of property passing to the surviving spouse at zero and thereby deny the marital deduction with respect to such property, though it qualified under all other provisions of Section 812(e) as a marital deduction to be excluded from the decedent's gross estate for estate tax purposes. This indirection, not authorized under Section 812(e)(1)(E)(ii), would completely destroy the marital deduction provided by Congress, and would tax this very property twice by including it in the decedent's net estate and in the surviving wife's estate on her death. Congress has decreed this property should be taxed only once.

Section 812(e)(1)(E) provides:

> "* * * In determining * * * the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection * * * (ii) where such interest or property is encumbered or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest here being determined."

Both the trial court and the Court of Appeals recognized and held the Regulations relied upon by petitioner, Treasury Regulation 105 (1939 Code), Sec. 81.47c(b), to be an unauthorized extension of the Statute insofar as such Regulations attempted to extend such Statute to include an election of the character here involved. Such conclusions are unquestionably correct as the Regulations fail to give effect to the last clause of the valuation statute last quoted to the effect that in valuing the interest to be excluded, the encumbrance or obli-

gation referred to "shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."

The legislative intent as expressed in Senate Supp. Report No. 1013, Part 2, 80th Cong., 2nd Sess. page 1163, House Report No. 1274, Part 2, 80th Cong., 2nd Sess. page 1258, also requires such conclusion. Such Statute clearly refers to the net value of the property itself that passes and not to the net benefit to the surviving spouse as claimed by the petitioner. It is apparent that in determining the amount of the marital deduction, only the net value of the property itself, that passes, is to be considered.

It seems clear to the respondents, as determined by the trial court, that the encumbrance or obligation, referred to in the statute and to be taken into account in valuing the property to be excluded, means an encumbrance or obligation on the property such as a lien against the property or debt as distinguished from an obligation or encumbrance in the nature of a condition or option under the election here involved. *Wachovia Bank and Trust Co. v. United States (Ct. of Cl. 1958), 163 Fed. Supp. 832.* The Court of Appeals did not find it necessary to pass upon this contention asserted by respondents, but concluded, as did the trial court, that the last clause of the statute last quoted lays down the formula for determining the valuation, namely, that it shall be taken into account in the same manner as if a gift of such interest by the husband to his wife were being determined.

Applying this test, it cannot be questioned but that, if Mr. Stapf had made an inter vivos gift of his ⅓rd interest in his separate property to Mrs. Stapf upon the condition or based upon her promise to make a gift of 1/6th of her community property to a Trustee for their children, the full amount of the gift from the husband to the wife, unreduced by the amount of the gift by the wife to the trust, would have been a gift or transfer subject to gift tax. *Commissioner of Internal Revenue v. Wemyss, 324 U.S. 303, 89 L. Ed. 958.*

In the case last cited, it was held that a transfer of stock to a prospective bride in consideration of her agreeing to marry the donor, was not a consideration in money within the meaning of the Gift Tax Statute. It was there held, the fact that the prospective bride was not willing to give up the loss of trust income provided for her under a prior trust, which relinquishment would have benefited her son by a prior marriage, unless the gift of stock to her by the prospective groom was made, did not affect the transaction since there was no money consideration benefiting the donor (the prospective groom) as a result of the prospective bride relinquishing to her son her income under the trust from a former marriage. In this connection Mr. Justice Frankfurter, delivering the opinion of the Court, stated:

> "If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct. See Commissioner of Internal Revenue v. Bristol (CCA 1st), 121 F(2d) 129. To be sure, the Revenue Act of 1932 does not spell out a requirement of benefit to the transferor to afford relief from the gift

tax. Its forerunner, sec. 320 of the (June 2) 1924 Act, 43 Stat 253, 314 c 234, 26 USCA Int Rev Acts 1940 ed p 81, was more explicit in that it provided that the excess of the transfer over 'the consideration received shall * * * be deemed a gift.' It will hardly be suggested, however, that in re-imposing the gift tax in 1932 Congress meant to exclude transfers that would have been taxed under the 1924 Act. The section taxing as gifts transfers that are not made for 'adequate and full (money) consideration' aims to reach those transfers which are withdrawn from the donor's estate. To allow detriment to the donee to satisfy the requirement of 'adequate and full consideration' would violate the purpose of the statute and open wide the door for evasion of the gift tax. See 2 Paul, supra at 1114."

See also *Commissioner of Internal Revenue v. Bristol, 1st Cir. 121 Fed. 2d 129 at 133; Lowndes and Kramer, Federal Estate and Gift Taxes (1956), pages 739, 740, Sec. 4; Merten's Law of Federal Gift and Estate Taxation, Vol. 1, Page 287, Sec. 5, 11; Estate of John M. Goetchins, 17 T.C. 495; Estate of Koert Bartman, 10 T.C. 1073.*

In the last cited decision *(Estate of Koert Bartman)*, in which the Commissioner of Internal Revenue acquiesced, CB 1948-2, page 1, it was pointed out that the gift tax is an excise tax imposed, not upon the receipt of property by the donee, but upon the act of the donor in making the gift, and that the tax is measured by the value of the property passing. It was held there, among other things, that where a husband gave his children certain property in consideration of their undertaking to pay an annuity to the donor and a contingent annuity to the donor's wife, should she survive, that the value of the annuity to the donor should be deducted

in valuing the property transferred, but no deduction should be made for the annuity undertaken by the donee for the benefit of the wife of the donor who was a third party to the transaction.

Petitioner does not question the accuracy of this Court's opinion in *Commissioner v. Wemyss*, supra, but would like to imagine the Court's holding that the prospective groom in effect made a gift, not to his prospective bride in consideration of her promise of marriage, but to her son by a former marriage. Any such distortion of this Court's holding is completely unjustified under the Court's opinion.

In like manner, petitioner seeks to bypass the *Wemyss* case by asserting the testamentary bequest of the testator of ⅓rd of his personal property and his ½ community interest in the automobile was not a bequest to Mrs. Stapf, but was a devise of property to the Trustees for the benefit of his children. This is simply not correct either in fact or in theory. We are concerned here only with the decedent's ⅓rd interest in his separate property and his ½ interest in the family automobile which, under the indisputable provisions of the will, passed to the surviving spouse absolutely. No part of such property passed to the control of the Trustees for the benefit of their children and the surviving spouse was free to use or dispose of this property in any manner she desired, including testamentary disposition thereof on her death, and such property, if not used or consumed by her during her lifetime, will be a part of her gross estate subject to estate tax upon her death. Mrs. Stapf did not exchange her property with her husband. There was no consideration in money or

money's worth passing to her husband from Mrs. Stapf as would be required under the *Wemyss* decision to reduce the amount of the gift from the donor for gift tax purposes. The estate of the decedent was not augmented by the fact that Mrs. Stapf, by her election, permitted her 1/6th interest in the community property to pass to the Trustees for the children; no consideration in money or money's worth passed to the decedent or the decedent's estate. Even if it be considered that Mrs. Stapf did not make a gift to the Trustees that was subject to gift tax consequences and she permitted testamentary disposition of $25,000.00 of her property to be made by her husband's will, this permission is not a monetary consideration any more than the promise of marriage in the *Wemyss* case, and did not reduce the value of the property that passed to her from Mr. Stapf any more than the value of the stock passing to the prospective bride in the *Wemyss* case was reduced.

The respondents make no contention that the remaining ⅔rds of the separate property of the decedent and his ½ share of the community property (other than his ½ interest in the community owned automobile) are not includable in the decedent's gross estate and are not subject to Federal estate taxes. The ⅔rds share of the decedent's separate property and the decedent's ½ share of all community property (other than the family automobile) passed from decedent to the Trustees for the benefit of the named children and no part thereof is claimed to be excludable under the marital deduction provisions for the simple reason that such property did not pass to the surviving spouse.

Under the Revenue Code of 1939, Section 105, it is provided that where a gift is made in property, the value thereof at the date of the gift shall be considered as the amount of the gift. Regulation 108, Sec. 86.19, in expounding upon such section, defines fair market value of the property on the date of the gift as the yardstick for measuring the amount of the gift. Such section of the Gift Tax Statute and Regulations thereunder with which the respondents have no quarrel are obviously applicable under the provisions of Section 812(e)(1)(E)(ii), in valuing the property that passed from the decedent to the surviving spouse in the present case.

No dispute exists as to the valuation of the ⅓rd interest in the separate property and the ½ interest in the family automobile as finally determined by the Commissioner on audit of the estate tax return, paragraph 10 of Stipulations filed in trial court (R. 39). It is only the ⅓rd interest in the community property and the ½ interest in the automobile that in any manner qualify for the marital deduction insofar as the present question is concerned; and since such property passed to the complete control of the surviving spouse upon her election, the value of same is entitled to be deducted under the marital deduction provisions in determining the estate tax liability of the decedent, which is the only matter presented for issue. By no stretch of the imagination can it be said that this property passed to anyone other than the surviving spouse or that it passed "through" the surviving spouse to any other person.

The gift tax consequences of the passage of Mrs. Stapf's 1/6th share of the community property from Mrs. Stapf to the Trustees for the benefit of her children is not in issue here and is not before the Court for consideration. The fact that under the Gift Tax Statute and cases construing such Statute, the surviving spouse may be entitled, in determining the value of her taxable gift to the trust, to subtract therefrom the value of the property passing to her under the decedent's will, would not be presented for determination by this Court if writ of certiorari were granted.

If this is a matter, which, in the opinion of petitioner, needs congressional action, relief should be sought there, and not here because of the limited issue here presented, and because of the clear and express provisions of the Statute here in issue. Such statutory provisions require the conclusions reached by both the trial court and the Court of Appeals that the property unquestionably passing to Mrs. Stapf qualifies for the marital deduction, and its value is not to be reduced to a negative value in decedent's estate for estate tax purposes merely because Mrs. Stapf's gift tax consequences might be lessened as a result of her election by which she received absolute title to certain of decedent's property, of an unquestioned value to her, equal to the value of such property in the hands of the decedent.

To disregard the clear requirements of the marital deduction statute, and to attribute to such statute an intent contrary to the express provisions, simply because there might be loss of taxation revenue under the gift statute, as the court below refused to do, and as the petitioner con-

tends should be done, is to emasculate, by the desire for greater taxes, the marital deduction provisions. This would levy an estate tax twice on property which Congress has said should be taxed only once. The petitioner's contentions, if sustained, but not the decision of the Court of Appeals, would destroy the clear intent of Congress in the enactment of the marital deduction statute.

II. THE DEDUCTION FOR CLAIMS AGAINST THE ESTATE

Petitioner misconstrues or ignores the limits of the holding of the Court of Appeals below. The Court did not hold that every debt was deductible in its entirety, but its holding as to deductible claims is limited by the facts involved in this case to administration expenses and debts imposed by law. If the debts claimed as deductions were founded upon a promise or agreement, the deduction thereof as a claim against the estate would be limited, under the decision below, to ½ of such indebtedness where ½ of the consideration received under the debt, such as the proceeds of a loan, went into the estate of the surviving wife. The concern of petitioner over the possible loss of taxation revenue is exaggerated.

The decision below involving Texas law can only affect Texas estates and has a limited application. This is true since Sec. 812(b) of the 1939 Internal Revenue Code specifically provides that the law of the state under which the estate is being administered is determinative of what claims against the estate are to be allowed as deductions. *First-*

Mechanics Nat. Bank of Trenton, et al. v. Commissioner of Internal Revenue, 3rd Cir., 117 Fed. 2d 127; Lang's Estate v. Commissioner of Internal Revenue, 9th Cir., 97 Fed. 2d 867; Thompson v. Wiseman, 10th Cir., 233 Fed. 2d 734; Blair v. Stewart, 5th Cir., 49 Fed. 2d 257.

If the debt and expense assumption by the decedent is to be treated, not as a claim against the estate, but as a legacy or testamentary gift to the surviving spouse, then, as admitted by the petitioner on page 15 of the petition, such assumption or legacy would qualify as a marital deduction, to the extent that the amount thereof, together with other testamentary gifts to the wife qualifying for the marital deduction, do not exceed one-half of the "adjusted gross estate", thereby reducing the taxable estate just as effectively as if the debts assumed were deducted under Section 812(b) of the 1939 Code.

Likewise, if only one-half of the community debts and administration expenses are deducted in the decedent's estate as claims against such estate, then in Texas the other one-half of administration expenses are allowable as income tax deductions to the surviving wife under Section 23(a)(2) of the Internal Revenue Code of 1939. See Revenue Ruling 55-524, Cumulative Bulletin 1955-2, page 535. As pointed out by Jackson in *Community Property and Taxation, 12 Southwestern Law Journal, page 37*:

> "From a tax point of view this treatment of administration expense works to the advantage of the family. The income tax deduction to the surviving spouse is

generally more beneficial than the estate tax deduction since income tax rates are usually higher than the estate tax rate."

The example on pages 14 and 15 of petition, as expanded by footnote 16 on page 15 of the petition, by which an estate of $1,000,000.00 gross community property and $500,000.00 community debts could escape taxation for estate tax purposes by the assumption of the indebtedness by the husband in his will and the comparison of a like situation to a non community property estate is not only not justified by the opinion of the Court of Appeals, but is contrary thereto. This is made clear in paragraph "Third" of the opinion, App. 13a. The Court there points out that the debts that may be deducted in determining the taxable estate are only the debts imposed by law. It is there further specifically held that the contention of the Government that only ½ of the debts founded upon a promise or agreement would be deductible in the decedent's estate under a provision of the kind here involved was correct. The Court stated in this connection, App. 13a:

> "The contention of the government would be well taken if the debts were founded on contract; otherwise a deduction could be claimed against the estate of decedent for a debt where one-half of the consideration received under the debt, such as the proceeds of a loan, went into the estate of the surviving wife. Here, however, no effort has been made to segregate the debts as between being founded on contract or imposed by law and none are pointed out as arising under contract."

Thus, in Texas and other community property states, contrary to petitioner's present assertion, the taxable estate

of the decedent could not be reduced to zero by borrowing money or incurring debts for the community estate equal to ½ of the total gross estate, under the express holding of the Court of Appeals. Any funds so borrowed would equally benefit the wife's ½ of the community estate and the husband's ½ of the community estate, and would not be deductible in the full amount of the indebtedness since such indebtedness would be founded upon a promise or agreement, and, under Section 81.36 of Regulations 105 (1939 Code), would be limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. Thus, under the holding of the Court of Appeals, the deduction in the exampled estate would be limited to ½ of the borrowed funds and the net taxable estate would be $250,000.00 in both the common law and community property state, under hypothetical cases presented on pages 14 and 15 of the petition.

When the various contingent situations are considered in their proper perspective and the opinion of the Court of Appeals is properly construed, it is obvious that no breath-taking loss of taxation revenue will result from the application of the decision below.

The concern that uniformity in the application of the Statute with respect to deductions as between common law and community property states cannot be made the basis of a decision herein because under the very provisions of Section 812(b) of the Revenue Code of 1939, the allowance of such deduction vel non and the quantum of the deduction

is determined by the laws of the state in which the estate is being administered.

Actually uniformity is not achieved even in the same state. This is made clear by Judge Wisdom in his dissenting opinion, where he points out, App. 33a, that in Texas, should the husband die first, ½ of the costs of administration are charged against his estate, *Katherine Schuhmacher, 8 T.C. 453 (1947)*. But should the wife die first, all of the expenses of administration are deductible, *Blackburn's Estate v. Commissioner, 5 Cir., 1950, 180 F. 2d 952*. Lack of uniformity could not be more evident.

Uniformity in the application of the statute with respect to deductions was not expected by Congress as was pointed out by the U. S. Court of Appeals for the Third Circuit in *Commissioner v. Cardeza's Estate, 173 Fed. 2d 19.*

In practice, uniformity in treatment of deductions by the estate is certainly not achieved. Perhaps the lack of uniformity can best be illustrated by a reference to a few of the community property states. Thus, funeral expenses are deducted in their entirety from the ½ community property interest of the decedent if the estate is administered in Texas *(Blair v. Stewart, 49 Fed. 2d 257, 5th Cir., cert. denied, 284 U. S. 658)*, or in Idaho *(Estate of W. S. Lee v. Commissioner, 11 T.C. 141)*, while only ½ of the funeral expenses are deducted if the estate is administered in the State of Washington *(Lang's Estate v. Commissioner, 97 Fed. 2d 867; The Pacific National Bank of Seattle, 40 BTA 128)*.

In the absence of will provisions otherwise directing, only ½ of the administration expenses are deducted in Texas upon the theory that the whole of the community estate is being administered. *Estate of H. C. Schuhmacher, 8 T.C. 453.* The same is true in the State of Idaho, *Estate of W. S. Lee, 11 T.C. 141,* but the contrary is held in the State of Louisiana, *Vaccaro v. United States, 55 Fed. Supp. 932; McCullough v. United States, 134 Fed. Supp. 673; Estate of Thomas N. Gannett, 24 T.C. 654; Estate of William G. Helis, 26 T.C. 143.*

The principle asserted by these respondents and upheld by the court below was clearly recognized and set forth by the Board of Tax Appeals of the United States in *Estate of Lucy O. McGugan, Deceased, 47 BTA 658,* in which the Commissioner of Internal Revenue acquiesced. The headnote or syllabi appearing in the official Board of Tax Appeals report clearly states in shortened form the holding of the Court as follows:

> "Funeral expenses and expenses of last illness of a married woman dying testate a resident of Florida, paid pursuant to the terms of the last will and allowed by the laws of the state as a charge against the gross estate, HELD, a legal deduction from the gross estate."

The facts in the case were that the will of Mrs. McGugan provided:

> "I direct that all of my just debts and funeral expenses be paid out of my estate as soon after my decease as shall be found convenient."

The decedent was survived by her husband, Arthur McGugan. Under the laws of the State of Florida the surviv-

ing husband was primarily liable for the payment of the funeral expenses. The Court, however, gave effect to the provisions of the will and required that the funeral expenses be paid out of the estate of the decedent pursuant to the terms of the will and deducted from the gross estate in determining the net taxable estate. The Court in such regard said:

> "• • • It has been held that, even though under the common law these expenditures are regarded as primary liabilities of the surviving husband, the husband is relieved of such liability where the wife directs in her will that they be paid out of her estate and leaves sufficient property for their payment.
>
> "It is clearly the purpose of the Federal estate tax law to permit the deduction of such items if allowed by the laws of the jurisdiction under which the estate is being administered. Since it is stipulated that the items in dispute were paid by the executor and that the administration of the estate has been closed, the items apparently were allowed as deductions from the gross estate by the laws of the State of Florida.
>
> "We are of the opinion that the respondent erred in his disallowance of the deduction from the gross estate of the funeral expenses and expenses of decedent's last illness."

Estate of Lucy O. McGugan, Deceased, supra, was followed by the Tax Court in *Estate of Mrs. Sarah H. Bradley, Docket No. 106452, Prentice-Hall 1948 T.C. Memorandum Decisions, 1195; CCH 2 TCM 609*. There the Tax Court had under consideration whether the funeral expenses of the decedent wife should be allowed as a deduction in computing estate taxes where, under the laws of Georgia,

where the estate was being administered, the surviving husband is primarily liable for such funeral expenses. The will in such case provided that all just debts should be paid and a marble slab erected over the grave of the decedent.

The principle that community debts are deductible in their entirety from the decedent's ½ community interest for determining estate tax liability where directed by the provisions of the decedent's will was recognized by the 9th Circuit Court of Appeals in *Lang's Estate v. Commissioner, 97 Fed. 2d 867,* where it is stated at page 871:

> "On this issue we think the Board was correct in permitting a deduction of only one-half of these community obligations. Regardless of the incidents of the husband's personal liability for community debts during his lifetime, section 1342, Remington's Revised Statutes, supra, as construed by the Supreme Court of Washington, requires that community debts be satisfied pro rata from that portion of the community property distributable to the wife and that portion subject to the husband's testamentary disposition. *It is only by provision of a deceased husband's will that a community debt may be charged solely against his share of the community.* Redelsheimer v. Zepin, 105 Wash. 199, 202, 177 P. 736; In re Hart's Estate, 150 Wash. 482, 492, 273 P. 735." (Italics supplied.)

The right of a testator to charge community debts and administration expenses against his ½ part or share of the community estate where same would not otherwise be chargeable in its entirety, is recognized: in the State of Washington, *Lang's Estate v. Commissioner of Internal Revenue,* supra; *Redelsheimer v. Zepin, 105 Wash. 199, 177 Pac. 736; In re: Hart's Estate, 150 Wash. 482, 273 P. 735;* and in the

State of California, where it was stated *In re: Marinos' Estate, 102 P. 2d 443:*

> "The law is clear that in the absence of an expression of a contrary intent, the entire community property, including the interest of the surviving widow, is subject to the debts and expenses of administration upon the death of the husband. * * * The converse is also true—that is, if the will designates that debts should be paid from the interest of the husband, the wife's share of the community property is exonerated, if the husband's share is sufficient to pay all such debts and expenses. * * *"

The rule so clearly stated in the case last cited is the rule in Texas. Debts and administration expenses, though chargeable against the entire community estate in the absence of specific provisions to the contrary, are chargeable in their entirety against the deceased husband's one-half where the will so directs. This rule of law is made clear by the Court of Civil Appeals for the Seventh Supreme Judicial District at Amarillo in the case of *Medlin v. Medlin, 203 S.W. 2d 635,* and by the Supreme Court of Texas when a writ of error was refused in such case.

Other Texas cases recognize the right of a testator to direct that debts and expenses be paid out of certain portions of his estate, and that the determination of whether debts, expenses or administration and attorneys' fees should be borne by the community estate depends upon the intent of testator as expressed in his will. We refer to *Thompson v. Thompson, 236 S. W. 2d 779, 149 Tex. 632,* and *Matthews v. Jones 245 S.W. 2d 974, writ refused.* In the case last cited the decedent had written a will and various codicils. The suit involved the

question of who should be charged with the debts and expenses under the will and codicils. It is stated at page 977:

> "Judgment was entered in the District Court exonerating one-half of the separate property left in trust for the widow from payment of expenses of last illness and funeral, indebtedness of decedent for benefit of separate property, one-half of community indebtedness, expenses of administration of entire separate property and one-half of the community estate, the federal estate tax, all inheritance taxes, and charging the one-half of the community estate and one-half of the separate property left in trust for the children with the payment thereof.
>
> "* * *
>
> "It is urged by appellants that the will of Percy Jones 'made no provision, ambiguous or otherwise, as to apportionment of the burden of debts, expenses of administration or taxes among the beneficiaries' and that 'the court should have placed the burden, as a matter of law, and not of construction;' that, as a matter of law, the property devised in trust for the widow should be charged with a pro rata share of such items. The determination of the question here presented hinges upon the intention of the testator as expressed in the will, as evidenced by its terms when considered as a whole if his intent can be determined therefrom."

There can be no question with respect to the intent of the testator, Lowell H. Stapf, to charge all, and not merely ½, of the debts to his ½ share and part of the community estate until its exhaustion, and next to the separate estate. It is equally clear that the same was true with respect to administration expenses, including attorneys' fees incurred in connection with the administration of the estate.

Under the cases above cited, it cannot be questioned that the testator, Lowell H. Stapf, was fully authorized and em-

powered to charge his share and portion of the community estate with all of the community debts and all of the costs of administration and to exonerate the ½ share of Mrs. Stapf in the community property from such debts and expenses. It cannot be questioned that Mr. Stapf did in his will everything possible to charge his ½ of the community estate with such debts and taxes. Since Mr. Stapf was permitted by the laws of the State of Texas to do just what he did by his will, then such debts and expenses are deductible in their entirety in determining the amount of net estate taxable for estate tax purposes because the state law determines what debts and expenses are to be deducted from the share and part of the estate being taxed, subject, however, to the limitation stated by the Court of Appeals that only ½ of the debts founded on a promise or agreement are deductible.

All arguments that only ½ of the debts are personal obligations of the decedent and therefore deductible only to such extent under the applicable regulations are ill founded and were properly answered by the Court of Appeals. As there pointed out this is, of course, a question of state law.

In Texas, the person to whom the various community debts are owed would be entitled to obtain a judgment against the decedent's estate for the full amount of such community debts. In fact, the general rule is that a personal judgment for community debts incurred by a husband can be obtained against the husband himself, or against his estate if he be deceased, and that, although the wife's interest in the community property is liable for the payment of community debts incurred by the husband, no personal judgment can be ob-

tained against her therefor. *Davis v. McCartney, 64 Tex. 584; Leatherwood v. Arnold, 1 S. W. 173, 66 Tex. 144; Anderson v. Bundick, 245 S. W. 2d 318, Tex. Civ. App., error refused n.r.e.; Rex Supply Co. v. Shepherd, 293 S. W. 342, Tex. Civ. App., error refused; Adams v. Bartell, 102 S. W. 779, Tex. Civ. App., error refused.*

Consequently, if the husband is the only one personally obligated on community debts, and if it can be said that only ½ of the community debts is a personal obligation, then the other ½ of his community debt would be the personal obligation of no one. It is submitted that it is improper to say, therefore, that the assumption of debts and expenses by the husband, as was done in this case, disqualifies ½ of such debts and a prorata part of the expenses because they do not meet the test of "personal obligations" of the decedent. Unquestionably, the community half of the surviving spouse is only secondarily liable for these indebtednesses, particularly under the provisions of the will. If a decedent, whose estate is only secondarily liable for debts and expenses, can assume such liabilities by the terms of her will, thereby rendering such debts deductible in her estate for estate tax purposes, as was the case in *Estate of Lucy O. McGugan, Deceased*, supra, and *Estate of Mrs. Sarah H. Bradley*, supra, then surely the debts and expenses assumed by a testator who was primarily and personally liable for such debts are deductible in their entirety in determining estate tax liability.

The Court of Appeals recognized and gave effect to the Texas decisions and properly analyzed and applied the local law of the State of Texas to this case, and determined the

decedent could obligate his estate by his will to pay the debts and expenses as he did. Such being true, then under the clear provisions of the Statute and Regulations the expenses and debts, to the extent they were allowed by the Court of Appeals, were clearly deductible as claims against the estate as was determined by the Court of Appeals.

CONCLUSION

As was pointed out by this Court in *The Hanover Bank, Executor, v. Commissioner of Internal Revenue, 369 U.S. 672, 8 L. Ed. 2d 187*, decided May 21, 1962:

> "A firmly established principle of statutory interpretation is that 'the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses.' Crane v. Commissioner, 331 US 1, 6, 91 L ed 1301, 1306, 67 S Ct 1047."

Applying such principles, the Court of Appeals concluded that the Statutes here involved were clear and required the decision entered herein. Petitioner cites no decision conflicting therewith.

Where the statutory language is clear, as it was here found to be by the Court of Appeals, then the proper rule to be applied was stated in *Hanover Bank v. Commissioner*, supra, as follows:

> "Under such circumstances we are not at liberty, notwithstanding the apparent tax-saving windfall bestowed upon taxpayers, to add to or alter the words employed to effect a purpose which does not appear on the face of the statute."

The petitioner here vigorously contends that because of the feared loss of taxation revenue a writ of certiorari should be

granted herein, and Sections 812(b) and 812(e) of the Revenue Code should be rewritten to avoid the feared loss of revenue which the petitioner asserts could possibly occur. Such argument is best answered by the concluding statement and footnote reference in *Hanover Bank v. Commissioner*, supra, as follows:

> "Nevertheless, the Government now urges this Court to do what the legislative branch of the Government failed or elected not to do. This, of course, is not within our province.[23]

"[23]We believe the Court of Appeals for the First Circuit was correct when it said in Fabreeka Products Co. v. Commissioner, 294 F2d 876, 879: 'Granting the government's proposition that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the Congressional thumb, not the court's.' See also Evans v Dudley (Pa) 295 F2d 713, 715, where the Third Circuit quotes this language from Judge Aldrich's opinion in Fabreeka Products."

For the reasons stated, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

W. M. SUTTON,
P. O. Box 550,
Amarillo, Texas.

H. A. BERRY,
P. O. Box 550,
Amarillo, Texas.

JERRY F. LYONS,
P. O. Box 550,
Amarillo, Texas.

WINSTON R. SMITH,
P. O. Box 550,
Amarillo, Texas,
Attorneys for Respondents.

APPENDIX A

INTERNAL REVENUE CODE OF 1939 (AS AMENDED, 26 U.S.C., 1952 ED.)

SEC. 812. NET ESTATE.

For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

* * * * *

(b) [as amended by Secs. 405(a), 406, Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 502, Revenue Act of 1950, c. 994, 64 Stat. 906]. *Expenses, Losses, Indebtedness, and Taxes.*—Such amounts—

(1) for funeral expenses,

(2) for administration expenses,

(3) for claims against the estate, and

(4) for unpaid mortgages upon, or any indebtedness in respect to, property where the value of decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,

as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered, but not including any income taxes upon income received after the death of the decedent, or property taxes not accrued before his death, or any estate, succession, legacy, or inheritance taxes. The deduction herein allowed in the case of claims against the estate, unpaid

mortgages, or any indebtedness shall, when founded upon a promise or agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth; * * *. There shall be disallowed the amount by which the deductions specified in paragraphs (1), (2), (3), and (4) exceed the value, at the time of the decedent's death, of property subject to claims. For the purposes of this section the term "property subject to claims" means properly includible in the gross estate of the decedent which, or the avails of which, would, under the applicable law, bear the burden of the payment of such deductions in the final adjustment and settlement of the estate; and, for the purposes of this definition, the value of the property shall be reduced by the amount of the deduction under the next sentence attributable to such property. * * *

For the purposes of this subchapter, a relinquishment or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, shall not be considered to any extent a consideration "in money or money's worth."

* * * * * *

(e) [As added by Sec. 361(a), Revenue Act of 1948, c. 168, 62 Stat. 110] *Bequests, Etc., to Surviving Spouse.*—

(1) *Allowance of marital deduction.*—

(A) *In General.*—An amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to

the extent that such interest is included in determining the value of the gross estate.

* * * * *

(E) *Valuation of Interest Passing to Surviving Spouse.*—In determining for the purposes of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—

* * * * *

(ii) where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such incumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

* * * * *

TREASURY REGULATIONS 105 (1939 CODE)

SEC. 81.36. *Claims against the estate.*—The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, whether or not then matured, and interest thereon which had accrued at the time of death. * * * Only claims enforceable against the decedent's estate may be deducted. Except as hereinafter stated, if the claim is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. * * *

SEC. 81.47a [as added by T. D. 5699, 1949—1 Cum. Bull. 181, 195]. *Bequests, etc., to surviving spouse.*—(a) *Allow-*

ance of marital deduction. In the case of the estate of a citizen or resident of the United States dying after December 31, 1947, there may be deducted the value of any property interest (except as otherwise provided in section 81.47b and 81.47d) which passed from the decedent to his surviving spouse. Such deduction is hereinafter referred to as the "marital deduction." The marital deduction is generally not available in case the decedent's gross estate consists exclusively of property held by him and his surviving spouse as community property under the law of any State, Territory, or possession of the United States, or any foreign country. (See section 81.47d.) * * *

* * * * * *

SEC. 81.47c [as added by T. D. 5699, 1949—1 Cum. Bull. 181, 206]. *Valuation of property interest passing to surviving spouse—*

* * * * * *

(b) *Property interest subject to an incumbrance or obligation.* Section 812(e)(1)(E) provides that where a property interest passed from the decedent to his surviving spouse subject to a mortgage or other incumbrance, or where an obligation is imposed upon the surviving spouse by the decedent in connection with the passing of a property interest, the value of such property interest is to be reduced by the amount of such mortgage, other incumbrance, or obligation. The passing of a property interest subject to the imposition of an obligation by the decedent does not include a bequest, device, or transfer in lieu of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or

of other marital rights in the decedent's property or estate. The passing of a property interest subject to the imposition of an obligation by the decedent does, however, include a bequest, etc., in lieu of the interest of his surviving spouse under community property laws unless such interest was, immediately prior to the decedent's death, a mere expectancy. * * *

The following are illustrative of property interests which passed from the decedent to his surviving spouse subject to the imposition of an obligation by the decedent:

(1) A decedent devised a residence valued at $25,000 to his wife, with a direction that she pay $5,000 to his sister. For the purpose of the marital deduction, the value of the property interest passing to the wife is only $20,000.

* * * * * *

(3) A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife.

* * * * * *

APPENDIX B

In the United States Court of Appeals for the Fifth Circuit

No. 18974

UNITED STATES OF AMERICA, APPELLANT-APPELLEE,

versus

DOROTHY ANNE STAPF AND B. T. WARE, II, EXECUTORS AND TRUSTEES OF THE ESTATE OF LOWELL H. STAPF, DECEASED, AND DOROTHY ANNE STAPF, INDIVIDUALLY, APPELLEES-APPELLANTS (AND REVERSE TITLE)

Appeal from the United States District Court for the Northern District of Texas

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(September 26, 1962)

Before BROWN, WISDOM, and BELL, *Circuit Judges.*

BELL, *Circuit Judge:* This is an estate tax case. The opinion of the District Court is reported at 189 F. Supp. 830. Suit was filed by the executors of the estate of Lowell H. Stapf for a refund of estate taxes and interest paid pursuant to a deficiency asserted against the estate.

All facts have been stipulated. Mr. Stapf died testate on July 29, 1953, a Texas resident and domiciliary. His will was probated in Texas where his principal estate consisting of separate and community property, was situated. His will put his wife to an election[1] either to elect not to take under

[1]The doctrine of election under the Texas law is well established. See *Dakan* v. *Dakan*, 1935, 125 Tex. 305, 83 S.W. 2d 620; *Smith* v. *Butler*, 1892, 85 Tex. 126, 19 S.W. 1033; and 44 Tex. Jur., Wills, § 285 et seq.

the will and thereby retain her one-half interest in the community estate, or to allow her one-half interest to be disposed of under his will in order that she might receive specified benefits thereunder.

The benefits included one-third of the residue, consisting of the whole of the community property and separate property of a value of $65,100 owned by the decedent, less specific bequests. The benefits also included an automobile, itself community property in which the widow owned a one-half interest. The will provided that if she should elect to take under its provisions, all funeral expenses, costs of administration and claims against the estate, whether community or separate, should be paid out of the one-half interest of decedent in the community property. Community debts totalled $32,367.74, while expenses of administration, including attorneys' fees, were $4,073.47 and the community of the husband was sufficient to pay these.

Electing not to take under the will, the widow would have retained her one-half of the community property, subject to its pro-rata share of expenses of administration and one-half of the community debts, having a net value of $111,442.68. Taking, she became entitled to one-third of the gross value of decedent's separate estate ($21,666.66), the one-half interest of the husband, value at $700 in the community automobile, and one-third of the combined community estate. This had a value of $106,268.18, or $5,174.50 less than the value of the interest Mrs. Stapf would have retained had she not elected to take under the will. Computed differently but with the same result, the widow

retained a one-third interest out of the one-half of the community owned by her, thereby transferring only a one-sixth interest under the election to take. Under this method of computation she transferred property having a valuation of $27,541.16 and received property being the one-third interest in the separate property of the husband and the one-half interest in the automobile of the aggregate value of the $22,366.66, making a net loss to her of $5,174.50. The government uses one method while the taxpayer uses the other. Either is sufficient for our purposes.

The taxpayer, having been notified of a deficiency after filing the estate tax return, paid the deficiency and claimed a refund. It being denied, suit was filed and this appeal is from the judgment of the District Court. The taxpayer appeals from the disallowance of the community debts and administration expenses as deductions from the gross estate of decedent under § 812(b) of the Internal Revenue Code of 1939, 26 USCA, § 812(b). The government appeals from the allowance of an exclusion from the gross estate as a part of the marital deduction of the one-third of the separate property of decedent and the one-half interest in the community automobile passing to the widow under her election to take under the will, contending that this devise was incumbered or obligated within the meaning of §812(e)(1)(E)(ii) of the Internal Revenue Code of 1939, 26 USCA, §812(e)(1)(E)(ii), in an amount exceeding the value of the devise received by the widow in that the property transferred by her was of a greater value than that received by her.

As to the deductibility of the total of the debts and expenses from the community of decedent alone,[2] §812 of the Internal Revenue Code of 1939, as amended, being the applicable statute, provides in part:

> "§ 812 NET ESTATE
>
> "For the purpose of the tax the value of the net estate shall be determined, * * * by deducting from the value of the gross estate—
>
> "(b) * * * such amounts—
>
> "(1) for funeral expenses[3]
>
> "(2) for administration expenses,
>
> "(3) for claims against the estate,
>
> "as are allowed by the laws of the jurisdiction, whether within, or without the United States, under which the estate is being administered, * * *. The deduction herein allowed in the case of claims against the estate * * * shall, when founded upon a promise or agreement, be limited to the extent that they are contracted bona fide and for an adequate and full consideration in money or money's worth * * *.

This section is the same as §303 of the Revenue Act of 1926 with respect to which it was said in *First-Mechanics Nat. Bank of Trenton v. Commissioner of Internal Revenue*, 3 Cir., 1940, 117 F. 2d 127:

> "Unquestionably a claim against a decedent's estate which is allowed by the laws of the jurisdiction under

[2]The debts of decedent totalled $32,367.74, all of which were community debts, including $23,701.34 due for 1951 income taxes, and interest thereon in the amount of $1,955.33. The expenses of administration totalled $4,073.47. The Commissioner determined that 65 percent of the expenses of administration should be allocated to and deducted from the gross estate of decedent, and the remaining 35 percent allocated to the widow's one-half of the community estate. This allocation was affirmed by the District Court and the allocation is conceded to be correct if the expenses are not deductible. Ad valorem taxes due amounted to $1,954.96.

[3]Allowed *in toto* here. *Blair* v. *Stewart*, 5 Cir. 1931, 49 F. 2d 257.

which the estate is administered is deductible in determining the net estate subject to federal tax. The Revenue Act applicable to the instant case specifically so provides."

Cf. *Blair v. Stewart*, Footnote (3), supra; and *Lang's Estate v. Commissioner of Internal Revenue*, 9 Cir., 1938, 97 F. 2d 867, on appeal from the Board of Tax Appeals, 34 B.T.A. 337. Thus, uniformity in the application of the statute was not expected by the Congress, and we look to the law of Texas to determine this issue.

The principle that community debts are deductible in their entirety from the community interest of the decedent in determining estate tax liability where directed by the provisions of the will was recognized, although not applied, in *Lang's Estate v. Commissioner*, supra:

> "On this issue we think the Board was correct in permitting a deduction of only one-half of these community obligations. Regardless of the incidents of the husband's personal liability for community debts during his lifetime, Section 1342, Remington's Revised Statutes, supra, as construed by the Supreme Court of Washington, requires that community debts be satisfied pro rata from that portion of the community property distributable to the wife and that portion subject to the husband's testamentary disposition. It is only by provision of a deceased husband's will that a community debt may be charged solely against his share of the community. Redelsheimer v. Zepin, 105 Wash. 199, 202 177 P. 736; In re Hart's Estate, 150 Wash. 482, 492, 273 P. 735."

There was no provision in the will in that case to charge the whole of the claims against the community of the decedent, but the holding was that the claims in any event were

not personal obligations of the decedent within the meaning of the Washington law as required by the regulation.

The Applicable Treasury Regulation, 105 (1939 Code), provides in pertinent part:

> "SEC. 81.29 *Deduction of administration expenses, claims, etc.*—In order to be deductible * * * the item must fall within one of the several classes of deduction * * * enumerated * * * and must also * * * be one of payment of which out of the estate is authorized by the laws of the jurisdiction under which the estate is being administered. Unless both of these conditions exist the item is not deductible. * * * If a claim against the estate, an unpaid mortgage, or an indebtedness is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth, * * *."
>
> "SEC. 81.32 *Administration Expenses.*—* * * Administration expenses include (1) executor's commissions; (2) attorney's fees; (3) miscellaneous expenses. * * *"
>
> "SEC. 81.36 *Claims against the estate.* — The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, * * *. Only claims enforceable against the decedent's estate may be deducted. If the claim is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. * * *"

Measured by the criteria of the statute and the regulation, which adds the additional requirement that the claims be personal obligations, we hold that the debts and expenses

here were deductible in full from the community interest of decedent, and reverse to that extent.

First, the Texas case law makes it abundantly clear that decedent by the terms of his will could so obligate his estate and his community property. *Medlin v. Medlin*, Tex. Civ. App., 1947, 203 S. W. 635; and *Matthews v. Jones*, Tex. Civ. App., 1952, 245 S. W. 2d 974. It is true that neither of these cases involved taxes, but the regulation here requires only that the payment be authorized under the Texas law. Cf. *In re Marino's Estate*, Cal. Dist. Ct. App., 1940, 102 P. 2d 443.

Second, the government contends that only one-half of the debts represented personal obligations of the decedent and for that reason only one-half may be claimed as deductible. Cf. *Lang's Estate*, supra. This, too, is a question of state law. The general rule is that on dissolution of the community the husband, but not the wife is personally liable for community debts. 31 C.J.S., Husband and Wife, §566b(1), p. 100. This is the law of Texas. A judgment could have been obtained against the estate of decedent for the full amount of the community debts. Of course, the community of the wife under Texas law is liable for payment of the community debts, and her husband could recover from it for advances made to pay community debts, but no personal judgment could be obtained against her for community debts. The surviving wife does not personally owe the community debts. *Leatherwood v. Arnold*, 1886, 66 Tex. 414, 1 S. W. 173; *Security Nat. Bank of Wichita Falls v. Allen*, Tex. Civ. App., 1924, 261 S. W. 1057; *Sargeant v.*

Sargeant, Comm. of App., 1929, 118 Tex. 343, 15 S. W. 2d 581; and *Anderson v. Bundick*, Tex. Civ. App., 1952, 245 S. W. 2d 318. The debts were personal to decedent and to him only under the Texas law. The fact that the community property or even his property was sufficient to pay the debts does not take them out of the personal category.

Third, it is contended that there was no full and adequate consideration for more than one-half of the debts. The statute itself was amended in 1932 to make it clear that this requirement applies only where the debt is founded upon a promise or agreement,[4] and thus we do not reach the question of consideration for the debts here were in the main for income taxes and ad valorem taxes, debts imposed by law. The contention of the government would be well taken if the debts were founded on contract; otherwise a deduction could be claimed against the estate of decedent for a debt where one-half of the consideration received under the debt, such as the proceeds of a loan, went into the estate of the surviving wife. Here, however, no effort has been made to segregate the debts as between being founded on contract or imposed by law and none are pointed out as arising under contract.

The direction in the will of decedent, and the Texas law, coupled with the provisions of the Revenue Statute and Regulation, make it clear that the total of the debts and expenses of administration as specified in the findings of fact by the District Court were deductible from the gross

[4]Senate Report No. 665, 72nd Congress, 1st Sess., p. 51 explains the amendment (§ 805 of the 1932 Act) as limiting the requirement for consideration to liabilities founded on contract, as distinguished from liabilities imposed by law or arising out of torts.

estate of decedent. The District Court erred in not so holding. Cf. *Estate of Lucy O. McGugan v. Commissioner of Internal Revenue*, 1942, 47 B.T.A. 658, where the expenses of last illness and funeral expenses were allowed as a deduction from the gross estate of the wife, although these expenses were the primary liability of the husband under Florida law, where the wife provided by her will for payment out of her estate. See also *Estate v. Sarah H. Bradley v. Commissioner*, Memorandum opinion, Docket No. 106452, 1943, CCH, 2 TCM 609 involving a Georgia estate to the same effect.

We affirm that part of the judgment holding that the devise to the widow of one-third of the separate property of decedent and the one-half interest in the community automobile qualified as a part of the marital deduction or exclusion from the estate of decedent.[5]

Certain basic facts must be borne in mind in considering this question. There was no exchange of property between the testator and Mrs. Stapf, and she did give to the testamentary trust set up by decedent more than she received under the will. Only decedent's one-half interest in the community property is includible in his gross estate for federal tax purposes, *Commissioner of Internal Revenue v. Chase Manhattan Bank*, 5 Cir., 1938, 259 F. 2d 231, and

[5]The Commissioner allowed the one-half community interest of the husband in the automobile as a part of the marital deduction. No issue was raised to such allowance by the government in the trial court where the allowance was affirmed. Now it is asserted that the Commissioner was in error in the allowance which was based on his belief that Mrs. Stapf would have received the automobile whether she elected to take under the will or not. While this belief of the Commissioner was incorrect because the devise of the automobile was also based on the election, under our decision we do not reach this question.

there is no contention that the property of the widow passing by the election under the will of decedent became a part of his gross estate for estate tax purposes. And, lastly, under the Texas law the devise of one-third of the whole community to the widow did not pass to her under the will but was satisfied out of her own one-half. *Jones v. State*, Tex. Comm. App., 1928, 5 S. W. 2d 973; and *Calvert, Comptroller v. Fort Worth National Bank*, Tex. Sup. Ct., 1962, 356 S. W. 2d 919.

The statute here in question, par. (e)(ii) of §812(e)(1), supra, having to do with the valuation of marital deduction property passing from a decedent to his surviving spouse is as follows:

> "(E) *Valuation of Interest Passing to Surviving Spouse.*—In determining for the purposes of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—
>
> "(ii) where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such incumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."

The government relies on Treasury Regulation 105 (1939 Code), §81.47c(b), which extends the language of this statute to include an election as here, specifying by example that in computing the marital deduction the value of the bequest to a widow is to be reduced by the value of the community property interest relinquished by her. Neither this section of the Act or its legislative history envision

such an example or result.[6] The regulation in this regard changes the plain terms of the statute by sweeping away the last clause thereof and must give way to the statute. *Kosland v. Helvering, 1936*, 298 U. S. 441, 56 S. Ct. 767, 80 L. Ed. 1268; *Miller v. Commissioner of Internal Revenue*, 5 Cir., 1956, 237 F. 2d 830.

We also put aside the contention of the taxpayer that an encumbrance or obligation to be taken into account in valuing the property to be excluded means an encumbrance or obligation on the property such as a lien against the property for a debt, as distinguished from an obligation or encumbrance in the nature of a condition as here under the election. *Wachovia Bank & Trust Co. v. United States*, Ct. Cl. 1958, 163 F. Supp. 832.

We look to the terms of the statute itself for its meaning. The last clause of it teaches how the valuation is to be computed and this is the key to the determination of this issue. It shall be taken into account in the same manner as if the amount of a gift of such interest by the husband to his wife was being determined.

The value of a gift by a husband to a wife of property, on the condition that she surrender to, or give for the benefit of a third party a portion of her property, would not be reduced or "netted" by the amount of property given up by the wife. There must be a monetary consideration or like benefit to the original donor before the value of the property surrender is to be deducted from the value of the gift. *Commissioner of*

[6]Senate Supp. Report No. 1013, Part 2, 80th Cong., 2nd Sess.; House Report No. 1274, 80th Cong., 2nd Sess.

Internal Revenue v. Wymyss, 1945, 324 U.S. 303, 65 S. Ct. 652, 89 L. Ed. 958; *Commissioner v. Bristol*, 1 Cir., 1941, 121 F. 2d 129; and *Estate of Koert Bartman*, 1948, 10 T.C. 1073. All that Mrs. Stapf did by her election was to take the property devised to her and in turn surrender part of her property to the trust for the benefit of her children. Within gift tax confines the community property of the widow passing under the will of the husband to others may not be "netted" against the devise to the widow, and thus testator, were the transfer inter vivos, would be liable for gift taxes on the full value of the devise.[1] Viewed in this light the devise of the one-half interest in the automobile and the one-third interest in the separate property of the testator qualify as a part of the marital deduction and the District Court did not err in so holding.

The gift and estate tax statutes complement each other. Here estate taxes are due now on the property of the husband with the devise to the widow excluded. It is a part of the marital deduction or exclusion on which taxes are deferred to the estate of the widow to be assessed on so much of it as survives on another day. The net of the transfer by the widow became subject to gift taxes at the time of the transfer. The property transferred by the widow will, to the extent of an amount equal to the devise to her, escape both gift and estate taxes. Nevertheless, and this applies alike to our holding on the deductibility of the debts and expenses of adminis-

[1] *Aliter* on the transfer by the widow. The devise would be "netted" against what she surrendered as she did receive consideration of the necessary type: *Commissioner v. Seigel*, 9 Cir., 1957, 250 F. 2d 339; *Commissioner v. Chase Manhattan Bank*, supra; and *Turman v. Commissioner of Internal Revenue*, supra.

tration here, it is something permitted by the statute and proscription, if indicated, is for the Congress.[8]

Having reversed in part and affirmed in part we REMAND for such other and further proceedings as may be necessary and which are not inconsistent herewith.

WISDOM, *Circuit Judge*, dissenting:

I respectfully dissent.

With deference, I feel compelled to say that, in my opinion, the result reached by the majority is repugnant to fundamental principles of community property law. Nothing in Texas law requires the holding. Nothing in tax law requires it. And, the decision is inconsistent with the purposes of the equalization provisions of the Revenue Act of 1948 which put an end to the tax War-Between-the-States.

I.

Testamentary Instructions to Pay Community Debts and Administration Expenses.

A. The Will

This case stands alone. As far as I have been able to discover, no one, in Texas or in any other traditional community property state, ever before dreamt up the notion that

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[8]On the subject of a windfall under another tax statute, it has been aptly said:

"Granting the government's proposition that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the congressional thumb, not the court's." *Fabreeka Products Co. v. Commissioner*, 1 Cir., 294 F. 2d 876,879, cited in *The Hanover Bank, Extr. v. Commissioner*, No. 224, Supreme Court, October Term, 1961, decided May 21, 1962, 40 L.W. 4385, — U.S. —, — S. Ct. —, —, — L. Ed. 2d —.

by instructing his executors to pay the community debts from his share of the community a testator could:

> (1) double the federal estate tax deduction for his half of the debts of the community and
>
> (2) correspondingly increase his widow's share of the community which, as her share by vested right, is not includible in his taxable estate.

This notion is so contrary to one's ingrained understanding of the community as a partnership, I question whether Stapf's will did indeed intend the executors to take the extreme position they have taken. The will does not, in terms, require it.

The will does make plain the testator's intention that the debts and charges against the community should be payable from his share of the community or from his separate property. This is a testamentary provision common in a community property state. "There is no doubt", as Judge Dooley, the district judge below, remarked, "that a testator may lawfully exercise selectivity among different portions or different devises and bequests of his estate and order an impact of liabilities resulting in disproportionate burdens, or even a total burden on the one hand and exoneration on the other, and that is true in respect of payment of taxes, even the Federal Estate Tax." 189 F. Supp. 830, 834. Usually, "the intention of testator [is] to give his wife her interest in the community estate free from all claims of debts so far as the other legatees [are] concerned." *Redelsheimer v. Zepin*, 1919, 105 Wash. 199, 177 p. 736. See also *In re Hart's*

Estate, 1929, 150 Wash. 482, 273 p. 735.[9] "This would allow of the division or partition of the community property between the surviving spouse and the heirs of the deceased spouse before debiting against such property the community property debts, so that the share going to the surviving spouse would go free of any liability for the community debt." 1 DeFuniak, Principles of Community Property Law, §211 (1943). The Texas cases cited in the majority opinion are to the same effect. *Medlin v. Medlin*, Tex. Civ. App., 1947, 203 S.W. 2d 635; *Mathews v. Jones*, Tex. Civ. App., 1952, 245 S.W. 2d 974. In such cases, the dispute is only over the construction of the will. There is no holding and no intimation in these decisions that the purpose or effect of a will such as Stapf's is to enable executors to take a tax deduction for paying the debts chargeable by law to the wife's share of the community.

A simple, reasonable construction of the will is that Stapf's purpose was to make the inducements so attractive Mrs. Stapf would feel duty bound to take under the will. Should she resist the will, her share of the expenses and debts would be payable from her half of the community. The legal effect of the pertinent testamentary language is to make a conditional gift or legacy to the widow in an amount equal to half of the charges against the community. The bequest is at the expense of the other distributees and effects a redistribution of the decedent's estate. But it is no different from instructions to the executors to pay the mortgage on a son's house, or to pay the debts of a third person. It is a straight pecuniary legacy.

[9] Both cases are cited in Lang's Estate v. Commissioner, 9 Cir., 1938, 97 F. 2d 867.

B. Texas Law

The basic error of the majority lies in their not recognizing that in the settlement of the community, following its dissolution, the community is regarded as a third person, vis-a-vis husband and wife. It is not a civil person in the common law sense, but time and again courts have referred to it as a separate entity. "[T]he laws of Washington establish a community between spouses which is a separate entity, 'just as a corporation or an association'."[10] More often, the community is described as a partnership. In a very early case the California Court said:

> "Our whole system, by which the rights of property between the husband and wife are regulated and determined is borrowed from the civil law and Spanish law. . . . The relation of husband and wife is regarded by the civil law as a species of partnership, the property of which, like that of any other partnership is primarily liable for the payment of its debts." *Packard* v. *Arellanes*, 1861, 17 Cal. 531, 537.

In Texas the community is sometimes referred to as a "trust," but "there is nothing in such a 'theory' that conflicts with the view of a marital partnership, a term frequently used by the Texas Courts, since it is merely designed to make clear that fiduciary obligations are imposed upon the one holding the legal title, the same fiduciary obligations which are imposed on any partner who has control and management of partnership assets." 1 DeFuniak, Principles of Community Property § 95 (1943). In an authoritative

[10] Lang's Estate v. Commissioner, 1938, 304 U.S. 264, 58 S. Ct. 880, 77 L. Ed. 1066.

discussion of Texas community property law,[11] Judge Hannah described the community:

> "The relationship of the spouses in Texas during their life time is substantially that of partners in a commercial partnership, and the husband and wife are in all respects equal partners, the husband being the managing partner and vested with management powers."

As DeFuniak comments, "It is difficult to see how it can be observed in any other light, for it represents the right to share equally in acquets and gains of the spouses during the marriage as well as liability for the obligations incurred on behalf of the community, usual attributes of partnership." 1 DeFuniak, Principles of Community Property, § 95.

In keeping with the view that the community is regarded as a partnership separate from the partners, Texas law provides that the community property of husband and wife "shall be liable for their debts contracted during marriage." Art. 4620, Vernon's Ann. Tex. Civ. Stat. And, Section 156 of the Texas Probate Code, provides:

> "Community property, except such as is exempt from forced sale, shall be charged with all valid and enforcible debts existing at the time of the dissolution of marriage by death."

No individual has the testamentary power to change this law of Texas. In every case the community passes with the debts of the community charged against it. Tex. Prob. Code §§ 45, 1516.

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[11] Rompel v. United States, S.D. Tex., 1945, 59 F. Supp. 483, *rev'd* United States v. Rompel (Herbst), 1945, 326 U.S. 367, 66 S. Ct. 191, 90 L. Ed. 137. This is the Texas companion case to the Louisiana case of Wiener v. Fernandez, E.D. La., 1945, 60 F. Supp. 169; *rev'd* Fernandez v. Wiener, 1945, 326 U.S. 340, 66 S. Ct. 178, 90 L. Ed. 116 upholding the constitutionality of the Revenue Act of 1942.

Death dissolves the community. Then, as in the dissolution of a partnership, there is in equitable accounting between the separate estates of husband and wife and the community. See 30 Tex. Jur. 2d, Husband and Wife, § 134 and cases there cited. The personal liability of the husband provides no basis for shifting to him all of the community debts, even if he has paid the debts from his separate funds. "The rule is settled that the separate estate of one spouse must be reimbursed by the community estate for advances from such separate estate." *Snodgrass v. Robertson*, Tex. Civ. App., 167 S.W. 2d 534, err. ref. W.O.M. Even when a husband is sued and held liable on a community debt, the wife's share of the community is not relieved of liability. "It is well settled in [Texas] that even though the wife is not named as a party to an action by or against the husband concerning the community property, she is still bound by a judgment rendered against the husband in the action. This rule is based on the doctrine of virtual representation under which the husband is by law, designated the representative of the wife's interests in the community." 30 Tex. Jur. 2d., Husband and Wife, § 167.

The husband's personal liability, on which the majority relies as the principal basis for their decision, does not reduce the community's liability. It does not affect the liability of the widow's share for half the debts. It does not increase the amount (one-half) of the claims against the husband's estate when the community is sufficient to satisfy the claims. Thus:

> "Under our law the community property is the primary fund for the payment of community debts, and we think that where there exists sufficient community

> property to pay the community debts, no resort can be had to the separate property of the deceased husband for the purpose of paying such debts, though such property is, of course, liable if the community property should prove to be insufficient." *Clark v. First Nat. Bank*, Com. App. Tex., 1919, 210 S.W. 677, 679.

In short, the personal liability of a husband is that of a surety. If a husband pays community debts out of his separate estate, the community reimburses the separate estate on dissolution of the community. The wife is a special partner in a limited partnership since her liability is limited to her share of the partnership assets. The general partner's (the husband's) liability is unlimited because it is he who has the control and administration of the partnership. But the husband's unlimited liability for community debts and the wife's limited liability for such debts are no more determinative of their respective rights and liabilities as owners of the community, than are the corresponding liabilities of a general partner and the special partner in a commercial partnership in the common law in determining their respective property rights and liabilities. The fact that only the husband may be sued does not relieve the wife's share of any liability; it is really the community that is sued and must pay the claim to the extent of the community estate.

This brings us to the question of the effect of Stapf's will under Texas law. Texas law is clear beyond a doubt: if there had been no will, since the community was able to pay its debts only half of the debts would be allowed against Stapf's estate. Should the will make a difference? No. The wife's share was charged with half the debts before Stapf's death. His death dissolved the community, making it impossible for

Stapf to change the status of claims fixed prior to his death. The only change the will could make would be by providing a method for payment of debts. But a testamentary direction to executors to make a payment from the decedent's estate, to the benefit of another, is simply a legacy.

If the reasoning of the majority were sound, logically Stapf's will should not affect the majority's conclusion. Their decision rests on the husband's personal liability for the community's obligations. But that liability exists without a will. It is completely independent of a will. Whether or not a husband is personally liable, when the community is dissolved Texas law divides the liabilities as it divides the assets.

C. Tax Law

1. *The "Claim" contemplated.* Section 812(b)(3), Internal Revenue Code of 1939, permits the deduction of such "claims against the estate as are allowed by the laws of the jurisdiction under which the estate is being administered." The state law does not apply of its own force. The federal tax law, for its own purposes, incorporates state law by reference. See Hart and Wechsler, The Federal Courts and the Federal System, p. 456; cf. *Towner v. Commissioner*, 182 F. 2d 903, 907 (2d Cir., 1950). The role played by state law in the taxing statute is explained by the Supreme Court in *Morgan v. Commissioner*, 309 U.S. 78, 80 (1940):

> "State law creates legal interests and rights. The federal revenue acts designate what interests or rights so created, shall be taxed. Our duty is to ascertain the meaning of the words used to specify the thing taxed. If it is found in a given case that an interest or right

created by local law was the object intended to be taxed, the federal law must prevail no matter what name is given to the interest or right by state law."

A similar principle should be applied in allowing or disallowing a claim under § 812(b)(3). The question to ask is whether a claim is the type of claim against the estate contemplated by the taxing statute.

The type of claim allowable as a deduction in determining the amount of a decedent's estate cannot be a claim based solely on the husband's personal liability for community debts. That is only a potential liability to creditors *which is washed out in this case* since the community property was sufficient to satisfy the debts of the community; claims against a solvent community after dissolution of the partnership are not against the decedent personally but are attributable to the marital estate. In the accounting between the separate estates of husband and wife and the community, the husband's liability would be for only half the claims. Regardless of the incidents of the husband's personal liability for community debts during his life time * * * community debts [are] satisfied pro rata from that portion of the community property distributable to the wife and that portion subject to the husband's testamentary disposition." *Lang's Estate v. Commissioner*, 9 Cir., 1938, 97 F. 2d 867. This puts the tax where it naturally falls, on half of the net community—the only part over which Lowell Stapf had testamentary control.

The salient feature of a true "claim" is its involuntary nature. The debtor owes the claimant money and the claimant

has a right to payment irrespective of the debtor's wishes. In this case the claim is provable against the testator's estate only because of the decedent's voluntary and gratuitous testamentary assumption of the claim. In *United States v. Mitchell*, 7 Cir., 1934, 74 F. 2d 571, the Seventh Circuit, in discussing whether an obligation, voidable under the Statute of Frauds, could be deducted if the executors had waived the defense and paid the claim, stated: "Nor can an asserted obligation which was enforceable only at the option of the deceased obligor be deducted."

2. *Authorities.* Neither *First-Mechanics Nat'l Bank v. Commissioner*, 3 Cir., 1940, 117 F. 2d 127, nor *Lang's Estate v. Commissioner*, 9 Cir., 1938, 97 F. 2d 867, relied on by the majority, supports the Court's holding. Each, especially *Lang's Estate*, points the other way. In *First-Mechanics* the court refused to allow as a deduction debts voluntarily paid by the state and approved by the state orphan's court. It concluded that since the estate was not obligated to pay the claim, the claim was not deductible. In *Lang's Estate*, as in this case, the taxpayers argued that under the law of the State of Washington, since "a husband is liable for community debts as fully as the community," the "entire amount of these community debts should be deducted from the gross estate." The court repudiated this contention:

> "Regardless of the incidents of the husband's personal liability for community debts during his lifetime, section 1342, Remington's Revised Statutes, supra, as construed by the Supreme Court of Washington, requires that community debts be satisfied pro rata from that portion of the community property distributable to the wife and

that portion subject to the husband's testamentary disposition. It is only by provision of a deceased husband's will that a community debt may be charged solely against his share of the community." *Redelsheimer v. Zepin*, 105 Wash. 199, 202, 177 P. 736; *In re Hart's Estate*, 150 Wash. 482, 492, 273 P. 735.

"If there be sufficient community property in the estate to discharge the obligations here in issue, then no more than one-half can be termed personal obligations of the decedent." *Lang's Estate v. Commissioner*, 9 Cir., 1938, 97 F. 2d 867, 871, 872.

In the next to last sentence of the quotation, on which the majority rely heavily, all that the court was saying was that Lang's will had not provided for payment of community debts out of his share; as a matter of *property law*, the claims were not provable against Lang's estate. The Ninth Circuit's citation of *Redelsheimer v. Zepin* and *In re Hart's Estate* makes this plain. Neither of these cases had anything to do with taxes; they turned on whether the testator intended burdening his share of the community with payment of all of the debts. Thus, *Redelsheimer v. Zepin*, holds that the testator intended "to give his wife her interest in the community estate free from all claims of debts *so far as the other legatees are concerned*." In *Hart's Estate* the court held that the testator intended "all debts should be paid first from the decedent's property, thus passing to the appellant her community interest in the estate free and clear of all of the community indebtedness." Of course, in the absence of a claim provable against the estate, as a matter of property law the question facing this Court did not arise.

All of the tax authorities agree that where, "under local law, a claim is both an obligation of the community as well

as a personal liability of the deceased husband, and it must be satisfied pro rata out of both shares to the extent that there are sufficient funds, no more than one-half is a 'personal obligation' of the decedent and hence only one-half is deductible." Mertens' Law of Federal Gift and Estate Taxation §26.20. See also Jackson, Community Property and Federal Taxes, 12 S.W.L. Jour. 43 (1958); Childress, Community Property in Administration of Estates in Texas, Tex. Inst., 5th Ann. Tax. Conf. (1957), 155, 167; Warren and Surrey, Federal Estate and Gift Taxation (1961), p. 710; Lowndes and Kramer, Federal Estate and Gift Taxes (1962), § 15.18, p. 347.

The executors find support for their position in two tax court cases dealing with funeral expenses: *Estate of McGargan*, 47 B.T.A. (1942) and *Estate of Bradley*, 12 P-H Tax Ct. Mem. 1195, CCH 2 TCM 609 (1943). These were Florida and Georgia cases; they did not involve community property. Besides, Stapf's funeral expenses are not at issue here; they were allowed as a full deduction. There is little or no analysis of the rationale for allowing the deduction in either case, other than the statement in *Estate of Bradley* that since the sums were actually expended by the executors and approved by the state court having jurisdiction, they were deductible. Such a statement is clearly incorrect. In *Fidelity-Philadelphia Trust Co. v. United States*, 3 Cir., 1955, 222 F. 2d 379, the Third Circuit held that executors' commissions were properly deductible only up to three per cent of the gross estate, even though the state orphans' court had allowed four per cent. "The fact that a

claim was presented and allowed in the probate court and subsequently paid by the executors has no bearing on the deductibility of the claim in question [in computing the net taxable estate]." *United States v. Mitchell*, 7 Cir., 1934, 74 F. 2d 571, 573; see *Estate of Schoenfeld*, 37 B.T.A. 36, 40 (1938).

The principles applicable to allowance of funeral expenses are completely inapplicable to allowance of debts or claims against the community. A claim for funeral expenses comes into existence *after* dissolution of the community. In *Blair v. Stewart*, 5 Cir., 1931, 49 F. 2d 257; *cert. den.* 1931, 284 U.S. 658, 52 S. Ct. 36, 76 L. Ed. 558, this Court, construing Texas law, held that funeral expenses, chargeable against "the estate" were chargeable against the only estate being administered, "the interest of the decedent in community property." Since that case, "it has been the uniform practice of examining revenue agents in Texas to allow all of the decedent's funeral expenses * * * as a deduction against the decedent's half of the community."[12] However, both courts and legislatures have stretched community property law in dealing with funeral expenses. Texas courts take the view that "a decent regard for the memory of the dead" warrants holding the community liable for funeral charges, and have expressly disapproved of *Blair v. Stewart*. *Norwood v. Farmers & Merchants National Bank of Abilene*, Tex. Com. App. 145 S.W. 2d 1100, 1103, *err. ref'd*; see also *Goldberg v. Zellner*, Tex. Com. App. 261 S.W. 801; *Richardson v. McCloskey*, Tex. Com. App. 276

[12]Childress, Community Property in Administration of Estates in Texas, Tex., Inst, 5th Ann. Tax Con. 155, 177 (1957).

S.W. 680; *Hocker v. Piper*, Tex. Civ. App. 2 S.W. 977; *Goggins v. Simmons*, Tex. Civ. App. 1958, 319 S.W. 2d 442.

3. *Tax Effects.* The subject of the federal estate tax is the transfer of economic interests. A decedent's assumption of the debts of another cannot change the total of the economic interests transferred. It can only divert part of the total by a legacy equal to the debts assumed.

Under the majority's holding, the rich and shrewd in a community property state can put the estate tax out of business. For example, in the twilight of their years, a couple with community property worth $1,000,000 could borrow an additional $1,000,000 and invest it in securities, using the $2,000,000 as collateral. As a result, the community property would be increased from one million to two million dollars, and would have debts against it of one million dollars. If the husband provided by will that all community debts be paid out of his share of the community property, upon his death his share of the community property would be worth $1,000,000. All of this, however, would be matched by deductible community debts. Thus, under the Court's holding, the entire "net" estate of $1,000,000 would pass, untaxed, to the wife.

If the majority decision is not corrected, the will of every informed taxpayer in all the community property states is certain to follow Stapf's will. Such taxpayers will enjoy a substantial advantage over taxpayers in common law states. With the same amount of property as that of a married couple in a common law state, a Texas widow's share of the

community will be larger than the marital deduction, to the extent of one-half of the debts. Judge Dooley pointed this out clearly, 189 F. Supp. 830, 834:

> "To say that a will with such provisions is effective under the law of Texas is not at all the same thing as saying that under the laws of the State of Texas, dealing with the allowance of claims in the course of probate and administration or in levying the state inheritance tax, the law puts the power in the hands of a testator at will to alter the amount of deductible debt obligations up or down, depending on whether the testator chooses to assume separately all of the community debts or prefers to let the survivor of the marital community bear one-half of such liability. The Federal Estate Tax Law was revised and altered materially in 1948 with the purpose of achieving approximate equality among taxpayers in community and non-community states. It is not readily apparent how a testator in a non-community state could very well duplicate the advantage sought in behalf of the present estate."

D. Costs of Administration

The majority opinion does not differentiate between funeral expenses, administration expenses, and debts. Each of these, however, is a distinct category controlled by its own rationale in the determination whether it is chargeable to the decedent's estate or to the community. They cannot be lumped together. The official Interpretative Commentary to Section 322 of the Texas Probate Code, for example, states that funeral expenses, expenses of administration, and expenses incurred in the preservation, safekeeping, and management of the estate "are not debts of the decedent". As pointed out in this opinion, notwithstanding *Blair v. Stewart*,

supra, Texas courts treat funeral expenses as charges against the community.

If the husband should die first, half of the costs of administration are charged against his estate, because the entire community is included within the administration.[13] *Katherine Schumacher*, 8 T.C. 453 (1947). If the wife should die first, all of the expenses of administration are deductible because only her half of the community is administered in her estate. *Blackburn's Estate v. Commissioner*, 5 Cir., 1950, 180 F. 2d 952.

The district judge, as I see it, properly allocated 70 per cent of the expenses of the administration to the community, that is, 35 per cent to the widow's share and the 35 per cent plus the remainder of 30 percent to the decedent.[14] This seems a fair allocation. As noted by Judge Dooley, the ex-

[13] DeFuniak explains the reason for this:

"The fact that where the husband dies the administration of the community property should be separate and apart from, although inside, the administration of the husband's estate which is taking place, seems not always to be understood. It must also be remembered that, although such an administration of the community property is taking place in order to pay community debts and accomplish a partition, half of the community property so being administered belongs not to the deceased husband but to the surviving wife, and always belonged to her from the moment of its acquisition during the marriage . . . . [A]dministration of community property is a thing apart from ordinary administration, in that it is actually settling up matters relating to property which belongs in equal shares to the decedent's estate and to a living person and not merely the administration of property belonging entirely to the decedent's estate." 1 DeFuniak, Principles of Community Property, Dissolution of Marital Community, § 205, p. 585, 586.

[14] Perhaps a better rule would be to fairly apportion these expenses between the estate and the surviving spouse on the basis of the time and effort expended on behalf of each estate. The services of the executor, the attorneys and accountants in seeing that the debts are paid and in getting half of the community into the hands of the surviving spouse are of benefit to the survivor's estate and some portion of these expenses may be equitably chargeable to such survivor." Jackson, Community Property and Federal Taxes, 12 S.W.L.J. 1, 37 (1958).

ecutors spent a great amount of their time in connection with the administration of the community. There is no good reason for giving Mrs. Stapf a free ride.

E. Conclusion

Strong economic, social, and moral reasons support the view that marriage is a full partnership between equal partners. Judge Dooley speaks for all of the traditional community states when he says, there is "a deep-rooted tradition . . . that liabilities against the whole community estate should be borne half and half, in the true spirit of the marital partnership." 189 F. Supp. 830, 835.

It is not easy to fit community property concepts smoothly into a tax system essentially derived from principles extracted from some sort of a "brooding omnipresence in the sky." As a consequence, for many years the integrity of the community property system as an institution was under almost continuous attack from taxpayers understandably resentful that citizens in common law states should pay higher federal taxes than citizens in other states. The attack reached its peak in the Revenue Act of 1942. This statute, ignoring the wife's vested ownership in community property and community earnings, treated her half as owned by the husband. The Act required the inclusion of the whole community in the taxable estate of the first spouse to die. The statute may have been motivated by ideals of tax equality and uniformity, it may have been grounded on sound tax arithmetic, but it struck a severe blow against what many persons regard as an enlightened concept of the

marital relationship and the status of married women. Finally, in the tax equalization provisions of the Revenue Act of 1948, after years of negotiation, a delicate but balanced reconciliation of interests was achieved by putting taxpayers in the common law states on the same paying basis as taxpayers in community property states "without tinkering with the property law of the states."[15] There are some who condemn the 1948 Act as not consistent with federal emphasis on control as the chief criterion in taxing, and as having generated new inequalities.[16] But the Act has saving graces. It works. The tax inequalities it created are relatively minor. In common law states the Act's reliance on check-book equality prevents any pressure from being exerted to introduce an alien legal institution. And, in community property states federal tax laws now no longer run counter to laws and customs long rooted in the civil law concept of the marital relationship as a partnership between husband and wife.[17]

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[15]Beveridge's phrase. Beveridge, 2 Law of Federal Law of Estate Taxation 181 (1956).

[16]See Surrey, Federal Taxation of the Family—The Revenue Act of 1948, 61 Harv. L. Rev. 1097 (1948); Anderson, The Marital Deduction and Equalization under the Federal Estate and Gift Taxes Between Common Law and Community Property States, 54 Mich. L. Rev. 1087 (1956). DeWind, The Approaching Crisis in Federal Estate and Gift Taxation, 38 Cal. L. Rev. 79 (1950). See also Memorandum Submitted by the Secretary of Treasury to the Senate Committee on Finance, March 1, 1948, Analysis of the Estate Gift Tax Provisions of H.R. 4790 (Revenue Act of 1948), reprinted in Warren and Surrey, Estate and Gift Taxation (1961). Lowndes and Kramer, Beveridge, and, not surprisingly, legal writers in the community states have found that after adoption of 1948 Act the sky did not fall. Beveridge, Law of Federal Estate Taxation, Chap. 14 (1956); Lowndes and Kramer, Chap. 17 (1962). See Thurman, Jackson, Riehm, Nossaman, and Ray, cited in notes 17 and 18. See also Golden, A Decade with the Marital Deduction, 97 Trusts and Estates, 304 (1958).

[17]See Thurman, Federal Estate and Gift Taxation of Community Property, 1 Ariz. L. Rev. 253 (1959); Jackson, Community Property and Federal Taxes, 12 S.W.L.J. 1 (1958). Riehm, The Impact of Community Property Law on Federal Taxation, 4 S.W.L.J. 161 (1950).

This decision imperils the tax reconciliation between the States. The irony of it is that in the name of Texas and taxes, the holding egregiously offends Texas law and tax law.

II. The Marital Deduction.

The election device, borrowed from the common law and an anomaly in a community property system, enables a testator to exchange a marital bequest for the power to dispose of his widow's share of the community over which, by law, he has no testamentary control.[18] The usual transaction is three-cornered, since the widow's property passes not to or through the estate but to a trust. Here, as a result of his widow's election, Lowell Stapf *increased* the amount of the property he controlled in his will.

The purpose of the marital deduction is to give to taxpayers in common law states the same tax benefits from a marital bequest that a surviving spouse has from her share of the community. To round it out, taxpayers in community property states are allowed a marital deduction up to one-half of the amount of the separate property.[19] The Act has

[18]For discussion of the Widow's Election and the Marital Deduction, see Ray, The Widow's Election—A Study in Three Parts, 15 S.W.L.J. 85 (1961); Westfall, Estate Planning and the Widow's Election, 71 Harv. L. Rev. 1269 (1958); Brown, The Widow's Election as a Tax Savings Device, 96 Trusts and Estates 30 (1957); Brookes, The Tax Consequences of Widows' Elections in Community Property States, U. So. Cal. 1951 Tax Inst. 83; Nossaman, Trusts Under The Revenue Act of 1948, U. So. Cal. 1950 Tax Inst. 459.

[19]This is not a deduction for bequests of separate property, as such. Aside from the effect of community property on the computation of the maximum allowable marital deduction, there is no difference pertinent here between community property and separate property. Community property may qualify for the marital deduction. However, the amount of the decedent's interest in community property must be subtracted (along with deductions for administration expenses and claims against the estate) from his gross estate to arrive at an "adjusted gross estate". Section 812(e)(2)(B), Code of 1939. The marital deduction cannot exceed 50 per cent of this adjusted gross estate. Thus, the amount of the marital deduction is limited or determined by the amount of separate property.

two built-in requirements integral to a bequest qualifying as a marital deduction: (1) *There must be no strings.* The surviving spouse to whom the bequest is made must be given rights substantially equivalent to the absolute rights a surviving spouse has in her share of the community. This is the price the husband pays to obtain the marital deduction. (2) *The property bequeathed must be includible in the widow's taxable estate* or must be subject to a gift tax on its disposition by gift, that is, taxed again in the same generation. This is the price the widow pays to obtain the marital deduction. These requirements tend to offset a large loss of tax revenue, taking into consideration the frequency with which persons of means would otherwise avoid taxation of a widow's estate by means of a testamentary trust with the income for life to the widow and the remainder to others. The marital deduction was sold to Congress and bought by Congress on these representations. The purpose and rationale of the Act, therefore, override the language. This is no place to bow down before literalism.

Here, it is just not a fact that Mrs. Stapf had the same rights to the bequest that she had over her community property. A survivor's ownership of a half interest in community property is absolute, unburdened, vested from the moment of the community's acquisition of the property. On the other hand, here the marital bequest was conditional and burdened with the obligation of the widow's giving up more than she received. The testator failed to pay the price he is required to pay for a marital deduction; the string he attached en-

abled him to control equivalent property, so that for all practical purposes, the property was part of his disposable estate.

The surviving spouse also failed to pay the price tax Congress put on a marital deduction: The bequeath did not increase her taxable estate by the amount of the property bequeathed. On the contrary, her taxable estate was reduced, since the value of her interest in the community, which she relinquished, exceeded the value of the bequest. She received no economic benefit from the bequest—except the tax savings. Moreover, she owed no gift tax, because she surrendered more than she received.

After the dust settled, the economic result of this transaction was a gift by the testator of $106,268.18 to the trust, and a gift by the wife of $5,174.50 to the trust. There was, therefore, no gift *to the spouse*. This is fatal to the executors' contention. The marital deduction is concerned only with a gift to a spouse. The Act is concerned with the economics of the transaction, as is evident from the fact that in determining the value of a bequest, "where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent . . . such incumbrance or obligation shall be taken into account". When the dollar-effect is a minus $5,000 result for the widow, it is unreal and obfuscatory to speak of the bequest as a gift to the spouse entitling the testator to a marital deduction.

The proper analytical approach, as I see it, is to recognize that we have a single three-cornered transaction involving

the husband (H), the widow (W), and the trust (T).[20] The bequest and the election cannot be separated and treated independently; the testator himself made that impossible. An example will clarify the approach, taking round numbers and changing the amounts so that they will be easy to follow. H dies, leaving $200,000 of separate property. The community amounts to $200,000. H's estate is $300,000; W's share of the community is $100,000. The will makes a bequest to W of $100,000 but puts her to an election requiring W to transfer her share of the community to T. W elects to take under the will, so her community interest of $100,000 goes to T. These are the economics: H has the same amount of property to dispose of as if he had made no bequest, $300,000, because of W's surrender of her property to H's testamentary control; W has the same amount of property, because the bequest of $100,000 is offset by the surrender of $100,000; T has $100,000 he did not have before. This is not my

[20]The approach we take is in keeping with Commissioner v. Siegel, 9 Cir., 1957, 250 F. 2d 339, affirming 26 T.C. 743 (1956). In that case the decedent's estate consisted entirely of community property. The husband's will created a testamentary trust with his widow as income beneficiary and his son as remainderman, and put his widow to an election. The basic question was whether the value of the gift is reduced by the value of the property received by the donor from a third person. The court considered it all one transaction and permitted the reduction. The surrender by the widow of her community property rights, in effect, was a gift to the estate of the decedent to the extent that the value of the interest surrendered exceeded the value of the interest received. The Court spoke of the transaction as "a contract supported by adequate consideration" and treated it as part gift and part exchange. To the same effect, see Chase National Bank, 25 T.C. 617 (1955), decided on other grounds, sub. nom. Commissioner v. Chase Manhattan, 5 Cir., 1958, 259 F. 2d 231.

I would distinguish Helvering v. Butterworth, 1933, 290 U.S. 365, 54 S. Ct. 221, 78 L. Ed. 365, on the basis of the difference between the Pennsylvania widow's dower-rights which had no value prior to her husband's death, and the Texas widow's interest in community property, which belonged to her prior to her husband's death and could be surrendered as the price of acquiring an interest in property which she did not heretofore own. See Brooks, The Tax Consequences of Widows' Elections in Community Property States, U. So. Cal. 1951 Tax Inst., 83, 88.

idea of the sort of a gift to a spouse that Congress had in mind when it enacted the marital deduction law.

Consider the tax effects, according to the majority holding. H would be entitled to a marital deduction of $100,000, bringing his estate down to $200,000. W owes no gift tax on the transfer to T, because the amount she transferred to T did not exceed the amount received. On W's death, there would be $100,000 only in her estate, if it were not consumed. Result, according to the majority: $100,000 escapes both estate and gift taxes. In 1948 the whisper of a rumor that the marital deduction might produce such a result would have torpedoed the Act.

In a common law state, the same result would be achieved only if the widow had property of her own. The scheme would have primary importance in a community property state because of the wife's ownership of half the community by operation of law. The majority's holding, therefore, tends to defeat the Act's purpose of placing all taxpayers on a par.

The result the majority reach is not dictated by the statute. Section 812(e)(1)(E) provides:

> "(E) *Valuation of Interest Passing to Surviving Spouse.*—In determining for the purpose of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—
>
> "(ii) where such interest or property is incumbered *in any manner*, or where the surviving spouse incurs *any obligation imposed by the decedent with respect to the passing of such interest*, such incumbrance or obliga-

> tion *shall be taken into account* in the same manner as if the amount of a gift to such spouse of such interest were being determined."

If we give the italicized words a common sense meaning, we must take them to exclude the necessity that the obligation be a pecuniary obligation, such as a mortgage, attached directly to the property. "Any" incumbrance or obligation is broad enough to encompass the absolute obligation the decedent imposed here. See Ray, the Widow's Election, 15 S. W. L. J. 85, 141 (1961).

The Court subordinates the meaning of the section as a whole to a literal interpretation of "gift" in the final clause: the obligation shall be "taken into account in the same manner *as if* the amount of a *gift* to such spouse were being determined". But, as in any "as if" situation, the very use of those two little words is implicit recognition that the thing treated "as if" it were the same is not the same. Some allowance, therefore, must be made for the lack of sameness where, for example, it would be inconsistent with the purposes of the legislation to treat the bequest here exactly as a gift. A bequest cannot be treated for all purposes as a gift; it is a testamentary disposition and the estate tax is involved.

The majority start with the premise that a marital bequest must be given the identical tax treatment as a gift. They point then to the unquestioned fact that in determining the taxability of a gift, a condition that the donee transfer a portion of her property to a third person does not reduce the value of the gift. The consideration must benefit the donor to relieve a transfer by him from being a gift. *Commis-*

sioner v. Wemyss, 1945, 324 U.S. 303, 65 S. Ct. 652, 89 L. Ed. 958. Since Mrs. Stapf's transfer went to the trust, not to her deceased husband, the majority hold that the value of the bequest was undiminished by the widow's election.

As pointed out, a view so literal defeats the purposes and rationale of the Act. On the other hand, if we bear in mind that in fact the bequest is a testamentary disposition, not an intervivos transfer,—the donor is deceased—it is constructive and in keeping with the intent of the Act to regard the bequest as a gift. We may accept the principle that in determining the value of a gift, benefits flowing to the donor, not detriment to the donee, is decisive. Here, then, to the extent possible and in the only way benefits may flow to a testator, Stapf received full consideration for his marital bequest by Mrs. Stapf placing her property within his testamentary control.

Wemyss is no obstacle to this approach. In that case the husband made an ante-nuptial transfer to his wife to compensate her for the loss of income from a trust established by her first husband; on her remarriage the income was to go to her child. This was held to be a taxable gift. But the donor in Wemyss, unlike the donor here, received no offsetting consideration or benefits from the immediate donee. Looking at the economic effects of the tripartite transaction in Wemyss, the husband made a gift to his wife's child, the income beneficiary of the trust. Wemyss, therefore, supports the argument I make here. In Wemyss, as in this case, because of the triangular nature of the transaction, the transferor made a

taxable transfer that, in effect, was a gift to a third person, not to the spouse.

This brings us back to the dominant statutory intention to provide a tax deduction for a non-community property taxpayer making a gift to his surviving spouse equatable with the widow's half of the community. To the extent it is a gift to the spouse, after taking into account all obligations imposed by the decedent, it qualifies for the marital deduction. If, instead, the testator uses his widow as an interposed party to make a gift to a third person the transfer to the spouse cannot be regarded as a gift to her. Thus, Lowndes and Kramer take note of the district court's holding in the case before us but nonetheless say:

> "[W]hat the Regulations are driving at seems to be this. If a decedent bequeaths property to his wife in lieu of her interest in community property, which is not part of his estate and which does not pass to her from him, it seems clear that the only thing which the surviving spouse actually receives from the decedent is the excess of the interest bequeathed to her over and above the value of her interest in the community property. *Therefore, this should be the only amount which qualifies for the marital deduction*". Lowndes and Kramer, Federal Estate and Gift Taxes, § 17.5 (1962).

The statute does not refer to the effect of a widow's election. Moreover, the terms "incumbrance", "obligation", and "taken into account" are imprecise. See 4 Mertens, Federal Gift and Estate Taxation § 29.53 (1959). It is especially appropriate, therefore, for Treasury to issue Regulations and for courts to give weight to the administrative interpretation of these terms.

Example (1) of Section 81.47c(b) of Treasury Regulations 105 is no different from the instant case.

> "(1) A decedent devised a residence valued at $25,000 to his wife, with a direction that she pay $5,000 to his sister. For the purpose of the marital deduction, the value of the property interest passing to the wife is only $20,000."

Example (3) of the Regulation provides for just such a contingency as has arisen here:

> "(3) A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife."

The Supreme Court has "many times declared that Treasury Regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons." *Commissioner v. South Texas Lumber Co.*, 1948, 333 U.S. 496, 501, 68 S. Ct. 695, 92 L. Ed. 836. I do not see any basis whatsoever on which the regulation governing marital deductions could be called "unreasonable and plainly inconsistent with the revenue statute".

I would hold that when a testator burdens a marital bequest with the condition that his widow surrender her property to his testamentary control the condition is an "incum-

brance" or "obligation" within the meaning of the Act. To the testator who is given power over property not otherwise within his testamentary control and to the spouse, the realities of the situation command recognition of the fact that the value of the bequest is the value of the property bequeathed over the value of the property surrendered by the surviving spouse. If the surviving spouse is worse off, this Greek-bearing-gifts bequest cannot qualify as a marital deduction, the justification for which is a no-strings spousal gift equivalent to the absolute ownership a surviving spouse has in the community.

I would AFFIRM the district court on the first point and REVERSE the district court on the second point.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Texas, and was argued by counsel;

On Consideration Whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed in part and reversed in part in accordance with the opinion of this Court; and that this cause be, and it is hereby, remanded to the said District Court for such other and further proceedings as may be necessary and which are not inconsistent with the opinion of this Court.

"Wisdom, Circuit Judge, Dissents."

September 26, 1962

DOROTHY ANN STAPF et al.

v.

UNITED STATES OF AMERICA

Civ. A. No. 2734
United States District Court

N.D. Texas

Amarillo Division.

Aug. 8, 1960.

DOOLEY, District Judge

STATEMENT

Lowell H. Stapf, being a resident for many years in Texas, died testate on July 29, 1953, and his will was thereafter duly probated in Potter County, Texas. The executrix and executor (simply executors herein) named in said will, duly qualified and timely filed an Estate Tax Return and paid the federal tax on the estate as computed in such return. Some months later the executors were notified by the District Director of Internal Revenue that a deficiency had been assessed and was claimed, materially increasing the tax against said estate. The alleged deficiency resulted principally from increasing the reported value of real estate and business property, reducing by half the full deductions taken for community debts, apportioning administrative expenses and attorneys' fees, which had been taken as a full amount deduction, and the denial of a marital deduction claimed in the return. These points of contention will be taken up separately and more in detail later herein.

The executors paid the amount of the deficiency assessed, plus interest, and have brought this suit to recover the amount of alleged overpayment in the amount demanded and collected by the District Director of Internal Revenue over the lawful tax liability of the estate.

This case will be determined under the Internal Revenue Code of 1939, as amended.

THE DECEDENT'S WILL

The most pertinent parts of the decedent's last will and testament will be dealt with in numbered sequence and are quoted or stated, as follows:

I

"My estate consists of both separate and community property. It is my purpose, in making testamentary disposition of my estate, to dispose of my separate estate and to dispose of the entire community estate as though it were my separate property, and my wife is requested to take under this will and waive her right to one-half of the community property. In the event she does not elect to take under this will, then my interest in the community estate and my separate property shall be held by the trustees hereinafter appointed for the benefit of my children, other than Lowell H. Stapf, Jr., share and share alike, and my wife shall not receive any part of my interest in the community property or any interest in my separate property."

III

This section provides a pecuniary legacy and a bequest of certain machinist tools to the decedent's son, Lowell H. Stapf, Jr.

IV

"I give, devise and bequeath to my beloved wife, Dorothy Ann Stapf, our personal automobile and one-third (⅓) of all the residue of my estate remaining after the bequest to Lowell H. Stapf, Jr., above set forth, and the bequest to her of our personal automobile."

V, VI and VII

These sections devise and bequeath the residue of the decedent's estate to the executors in the capacity of trustees for the use and benefit of Lee Dale Stapf, Donald Eric Stapf and Sylvia Rose Stapf, children of the decedent and his widow, to be managed as three separate but equal trust estates, and give directions, confer powers and detail the duties of the trustees.

IX

This section appoints Dorothy Ann Stapf and B. T. Ware II independent executrix and executor of the will and estate of the decedent, they having been appointed trustees also as just stated.

XII

In this section the decedent directed his executors "to pay all and not merely one-half of the following debts and charges out of my one-half part and share of our community property and estate, to-wit: All funeral expenses; all costs of administration incurred in connection with the administration of my estate, or as the result of my death, including, but not limited to, costs of court, attorneys' and accountants' fees; all debts owing by me, whether community or separate, all federal estate taxes attributable to my estate, and all state inheritance taxes attributable to the bequests and devises herein contained in Sections III and IV."

The quoted provision next above is immediately followed by terms which forbid recourse to the testator's separate property for payment of the items enumerated above "unless and until my one-half share and part of all community property has been exhausted," and which also forbid recourse to his widow's part of the community property and estate for the payment of any such items "until and unless my one-half share and part of our community property has been first exhausted and then my separate property has been next exhausted, except as hereinafter provided in the event my wife, Dorothy Ann Stapf, elects not to take under this will." The next and last provision in said section of the will is that all of the property devised and bequeathed in Sections III and IV of the will shall be taken free of liability on the items presently named, "provided, however, that in the event my wife, Dorothy Ann Stapf, does not

elect to take under this will then one-half of all debts of my estate, funeral expenses and costs of administration shall be charged to the one-half share and portion of the community estate of my marriage with Dorothy Ann Stapf vested in the said Dorothy Ann Stapf in accordance with the laws of the State of Texas.

The widow elected to take under the said will.

THE ISSUES

Life Insurance

The decedent, as insured, held three life insurance policies at the time of his death, all issued before the marriage of decedent and his surviving widow on December 22, 1945, each of the three for a face amount of $5,000.00, and at the time of his death the first was payable to his said widow, and each of the other two were payable to the widow and two of his children.

The premiums on the first policy were paid in the proportion of 16/20ths from his separate property before his said marriage and 4/20ths from the community property after his said marriage. The premiums on the second of such policies were paid in the proportion of 11/18ths from his separate property before his said marriage and 7/18ths from community property after his said marriage. The premiums on the third policy were paid in the proportion of 4/11ths from his separate property before his said marriage and 7/11ths from the community property after his said marriage. In the Estate Tax Return the three policies

were inventoried, but only on the basis of $2,500.00 for each policy and the stated reason was that the premiums thereon were paid from community funds of the decedent, but the examining officer of the Internal Revenue Service changed the amount to $5,000.00 for each policy, and the stated reason was that the policies were acquired prior to the marriage of decedent and his surviving spouse, therefore, the total amount was deemed includible in decedent's gross estate. Neither action was correct and, instead, the proper course is to allocate to the estate that part of the total insurance monies measured by the same proportion as the sum of the premiums paid from the decedent's separate estate, plus one-half of the premiums paid from the community estate bear to the total amount of all premiums paid.[1]

Community Debts and Administration Expenses

The Estate Tax Return reported community debts in the aggregate of $32,367.52. This was scaled down a half by the examiner and the reason stated was that one-half of such community indebtedness should be chargeable to the community estate share owned by the surviving spouse. The plaintiff's rejoinder is that the decedent's will, by a lawful provision, directed that all such indebtedness should be paid from the decedent's community property share, or, if necessary, from his separate estate. This poses a rather novel question. Article 4620, Vernon's Texas Statutes states

[1] Lang v. Commissioner, 304 U. S. 264; Berdoll v. Berdoll, 145 S. W. 2d 227; Jackson, "Community Property and Federal Taxes; Southwestern Law Journal, Vol. 12, pages 43-44.

that the community property of husband and wife "shall be liable for their debts contracted during marriage." This point is also echoed at more length in the authoritative decisions of the Supreme Court of Texas.[2] Section 812(b), Internal Revenue Code of 1939, permits the deduction of such claims against the estate "as are allowed by the laws of the jurisdiction * * * under which the estate is being administered." This statutory provision is subject to the further explanation in Treasury Regulations 105, §81.36, as quoted in the margin.[3]

The argument of plaintiffs that the direction in the decedent's will, purporting to shift the ordinary burden for half of the community debts from the widow's equal part of the community interest and concentrating all the indebtedness against the decedent's half of the community estate, sanctions the augmented debt liability in this case as a full legitimate deduction under the estate tax law is not a plausible stride. It will not do to say that a testator, at his own pleasure, may double the deductions by such a voluntary assumption as a testamentary device. For one thing, such a proposition would be in derogation of the federal statute and regulations which require that deductible debts must be personal obligations of the decedent at the time of his death. "If there be sufficient community property in the estate to

[2] Stone v. Jackson, 109 Texas 385, 210 S. W. 953

[3] "Claims Against the Estate
"The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, * * * and interest thereon which had accrued at the time of death. * * * Only claims enforceable against the decedent's estate may be deducted."

discharge the obligations here in issue, then no more than one-half can be termed personal obligations of the decedent."[4]

The reference in the federal statute, previously quoted, to "the laws of the jurisdiction", by fair intendment, means the statutory system for the administration of estates or for the levy of estate or inheritance taxes in the particular state. Of course, decisional law dealing with such statutes from a tax relevant standpoint would be a ruling factor too. There is no claim made here that there is any provision in the Probate Code or the inheritance tax statute of Texas which would confer the right of a testator to double in amount the statutory deduction for debts in a state community property inheritance tax proceeding, by a testamentary expedient, such as that here in question. Instead, the plaintiffs rely on some decisional law of Texas, recognizing the effect of testamentary directions of the kind being discussed in litigation between distributees and making proper accounting and adjustment of equities between the parties, but those cases are not deemed in point in the tax litigation.[5] There is no doubt that a testator may lawfully exercise selectivity among different portions or different devises and bequests of his estate and order an impact of liabilities resulting in disproportionate burdens, or even a total burden on the one hand and exoneration on the other, and that is true in respect to payment of taxes, even the

[4] Lang's Estate v. Commissioner, 97 F. 2nd 867, 871-2.

[5] Thompson v. Thompson, 236 S. W. 2d 779; Medlin v. Medlin, 203 S. W. 2d 635; Matthews v. Jones, 245 S. W. 2d 974.

Federal Estate Tax. In fact, plaintiffs have cited cases where such directions were given in respect to divers items, including such Estate Tax, but the distinction is that in none of the cited cases did the provisions of the will affect in the slightest the amount of such estate tax. To say that a will with such provisions is effective under the law of Texas is not at all the same thing as saying that under the laws of the State of Texas, dealing with the allowance of claims in the course of probate and administration or in levying the state inheritance tax, the law puts the power in the hands of a testator at will to alter the amount of deductible debt obligations up or down, depending on whether the testator chooses to assume separately all of the community debts or prefers to let the survivor of the marital community bear one-half of such liability. The Federal Estate Tax Law was revised and altered materially in 1948 with the purpose of achieving approximate equality among taxpayers in community and non-community states. It is not readily apparent how a testator in a non-community state could very well duplicate the advantage sought in behalf of the present estate. Actually, taking Texas alone, if this decedent had died intestate, no such benefit for the estate as that being dealt with could be claimed with any conviction for the estate.

It is noteworthy that for several years, 1942-48, the Federal Estate Tax Law was cast in the general pattern which in the typical case treated all the community estate as falling within the gross estate of the first dying member of the marital community for tax purposes, and during that time

the Legislature enacted a curious statute, which became Article 3683a of Vernon's Civil Statutes of Texas, and is quoted below.*

This short-lived statute reflected the deep-rooted tradition of the community property law of Texas that liabilities against the whole community estate should be borne half and half, in the true spirit of the marital partnership. In other words, the policy of the Federal Estate Tax Law at that time, in forcing the inclusion of the whole community properties against the first dying member for tax purposes struck a discordant note, clashing with the fundamentals of community property law, and the Article in question obviously was enacted to afford an equalizing remedy that would, after all, divide the burden half and half, unless the contrary was directed in the decedent's will. Of course, any such direction in a will of that spent interim would not have affected the amount of the estate tax.

Another obstacle is that the decedent's testamentary decision to take all of the community indebtedness as a liability alone against his part of the community estate and, if need be, his separate estate, lacks, at least as to many of

*"Whenever a Federal Estate Tax is collected under Section 811(e)(2) of the United States Internal Revenue Code, or any corresponding section hereafter enacted by the Congress of the United States, and such tax is measured in part by the value of the surviving spouse's interest in community property owned by the decedent and such surviving spouse at the decedent's death, the executors, administrators or personal representatives of the decedent, unless the decedent directs otherwise in his or her will, shall be entitled to recover from the surviving spouse such portion of the total federal estate tax paid under said Section 811(e)(2) as the net value of the survivor's interest in the community estate included in the decedent's estate in the computation of the federal estate tax bears to the net taxable estate."

This Article was repealed in 1955, upon the adoption of the Texas Probate Code, and such repeal is noted in §434 of said Code.

the debts, the requisites of a deductible claim, since it had no adequate and full consideration in money or money's worth. Whatever support such indebtedness has from the inception consideration accrued to the decedent and his widow equally in their marital community. The debts were the outgrowth of something antecedent and it would be unnatural to assume that his part of only one-half of the underlying considerations would be sufficient as a full and adequate justification to match his declared purpose to take over all of the liability evidenced by said debts. The particular nature of such antecedent considerations will be stated more definitely later in this opinion.

Then there is the more comprehensive, and also valid, argument of the defendant to the effect that the transfer of economic interests from the decedent is the event taxed under the Estate Tax Law, and since the decedent can transfer only that portion of his property remaining after the satisfaction of his personal liabilities and the expenses of administering the estate, a deduction is allowed for such obligations, which necessarily reduce the quantam of transferred property. Such is not the true case, however, where decedent in his will assumes the debts of another. The effect of such a provision, if executed, would not change, in the sense of the law, the total property transferred by the decedent, but rather would only divert part of it by a gift equal to the amount of the other's assumed debts.

The above has not been said unmindful that some cases can be cited for the viewpoint that the consideration required to support certain deductible claims under the Es-

tate Tax Law does not necessarily demand a consideration inuring directly to the decedent, but may be satisfied with other kinds of consideration connected with a transaction done in the ordinary course of business identified with some good common law consideration.[7]

The relevant part of the Internal Revenue Code of 1939, as amended, dealing with deductions for claims against the estate in computing the net estate for the purpose of taxation is copied in the margin.[8]

The point might be raised that a sufficient consideration exists in the present instance referable to the widow's election under the will of the decedent, resulting in her acceptance of a disparity in consideration, or, in other words, a detriment because the one-third residuary interest she took under the will was worth moderately less than the value of the one-half community interest she yielded. This was an inter-family transaction, non-commercial in nature, and to approve its effectiveness as a basis for the deduction of all the community indebtedness against the decedent's

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[7]Carney v. Benz, Exec. 90 F. 2d 747; Commissioner v. Bryn Mawr Trust Co., Ex'trs. 87 F. 2d 607. The reverse also has been held. Latty, Exec. v. Commissioner, 62 F. 2d 952.

[8]Title 26, §812.

"For the purpose of the tax, the value of the net estate shall be determined, in the case of a citizen or resident of the United States, by deducting from the value of the gross estate.—

* * *

(b) expenses, losses, indebtedness, and taxes. Such amounts

* * *

(3) for claims against the estate,

* * *

The deduction herein allowed in the case of claims against the estate, unpaid mortgages, or any indebtedness shall, when founded on a promise or agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth; * * * *."

estate would seem repugnant to the purpose and policy of the Estate Tax Law.[9]

In any event, apparently the Supreme Court has substantially settled the matter in the case of Taft, Exec. v. Commissioner, 304 U. S. 351, where the decedent in her lifetime promised educational institutions to establish an endowment fund and to pay salaries of orchestral musicians and a director of art, which were accepted and acted on by the institution, thus becoming a binding obligation against the estate under the state law, then the executor claimed a deduction for the amount payable under said promises, as being deductible claims, and the conclusion of the Court is reflected in the extract from the opinion quoted below.[10]

[9] "Deductions based on promises that run to and benefit members of the decedent's family, however, might well defeat the very purpose of the deduction section, which was to preclude family contracts and similar understandings made as a cloak to cover gifts or testamentary dispositions." MERTENS Law of Federal Gift and Estate Taxation. Vol. 1, §5.13, pp 297-8.

[10] "The claims against the estate were not incurred or contracted for an adequate and full consideration in money or money's worth within the meaning of the statute. The terms used, the legislative history of the section, and the regulations interpreting it, require this conclusion. The conditions imposed by the decedent as to the expenditure of the money promised and the stipulation on the part of the payee to expend it in that fashion, or its compliance with the conditions, do not constitute an adequate or a full consideration in money or money's worth within the meaning of the Act. If there were doubt about the matter, the legislative history of the statute and the Treasury regulations would require us to so hold. The Revenue Act of 1916 permitted the deduction of the amount of claims against the estate 'allowed by the laws of the jurisdiction * * * * under which the estate is being administered.' The Acts of 1918 and 1921 contain like provisions. Under these Acts the claims in question would have been deductible as enforceable by state law irrespective of the nature of the consideration. The Act of 1924 altered existing law and authorized the deduction of claims against an estate only to the extent that they were 'incurred or contracted bona fide and for a fair consideration in money or money's worth.' Congress had reason to think that the phrase 'fair consideration' would be held to comprehend an instance of a promise which was honest, reasonable, and free from suspicion whether or not the consideration for it was, strictly speaking, adequate. The words 'adequate and full consideration' were substituted by §303(a)(1) of the Act of 1926. There must have been some reason for these successive changes. It seems evident that the purpose was to narrow the class of deductible claims and we are not at liberty to ignore this purpose."

The principle of the Taft case has been followed with effect in the Court of Appeals for the Fifth Circuit.[11]

It follows that the claim made for deduction was properly disallowed to the extent of the one-half part chargeable to the widow's portion of the community estate. Neither counsel has submitted any decision by either the federal courts or the former Board of Tax Appeals or the present Tax Court, which is exactly parallel to this case, but even if it be a controversy of first impression, the proper disposition of it seems well foreshadowed by the authorities already mentioned, and there is also some supporting persuasiveness in other somewhat analogous decisions.[12] Moreover there is the rule that provisions for deductions which lighten the impact of a taxing statute should not be strained to find an allowable deduction.[13]

Next, attention will be turned to the subject of administration expenses, including attorneys' fees. In this estate the amount incurred and paid under above item was $4,073.47. On review, the Examiner prorated the sum by the ratio of 65% allocated to the estate and 35% allocated to the widow's one-half of the community estate. It is quite elementary under the community property system, as known

[11]Ensley v. Donnelly, 190 F. 2d 59.

[12]Parrott v. Commissioner, 30 F. 2d 792; Estate of George Herbert Atkins, Exec. v. Commissioner, 2 T. C. 332, 346-7; Estate of Herbert A. Schoenfeld, Administrator de bonis non, cta., v. Commissioner, 37 B. T. A. 36; Towner v. Commissioner, 182 F. 2d 903; Estate of Mrs. Matney Dyer Lucey, Exec. v. Commissioner, 13 T. C. 1010, 1018-9; United States v. Mitchell, 74 F. 2d 571; Fidelity-Philadelphia Trust Co. v. United States, 222 F. 2d 379.

[13]New Colonial Co. v. Helvering, 292 U. S. 435; Empire Trust Co. v. Commissioner, 94 F. 2d 307.

in Texas, that the wife from the outset owns a vested one-half interest in the community estate. The death of this decedent dissolved the community relationship and his widow's part of the community estate became her own exclusively and in absolute severalty of title, yet nevertheless remained liable on community debts. Her election to take under the decedent's will did not make her property a part of the decedent's estate, but by her consent it only became subject to disposition under the terms of the decedent's will. In other words, the identity of her former interest in the community estate, which had become her separate and exclusive property, was not lost with respect to liability for community obligations and for that purpose was rightfully administered along with the decedent's separate and community property by the executors named in his will. So far as the record shows such combined administration in this instance was not merely perfunctory. A fairly large sum of debts, chiefly taxes, including the major item of some $25,000.00 owed as income taxes and interest for 1951, had to be paid. The other listed debts were accounts owed to merchants, utilities, an insurance agency and a physician. Then, of equal importance, the largest single asset of the estate being administered was Globe Foundry & Machine Company, finally valued at $87,710.80, which was described in the Estate Tax Return as a "going business". This evidently required active administration. The executors qualified in August 1953 and filed the Estate Tax Return in October 1954, and it is understandable from the circumstances of this record that their duties may well have re-

quired rather active attention from the executors. They had need also for advice and services of legal counsel. The business of liquidating the community debts and the conservatory function in regard to the going business aforesaid were of concern and interest affecting the widow's one-half of the original community estate. In making the apportionment for the administration expenses, including attorneys' fees, the Revenue Examiner evidently derived the fractions by a computation that showed the aggregate of the decedent's separate property and his portion of the original community estate comprised 65% of the total separate and community property owned by him and his wife at the time of his death.

This apportionment is found to be justified as fair and reasonable and will be sustained.[14]

Marital Deduction

The plaintiffs in Schedule A, Real Estate of the Estate Tax Return, listed three business lots as separate property of the decedent, valued at $40,000.00, and in Schedule M claimed a marital deduction in the amount of $13,333.33, being the one-third interest therein attributable to the like fractional interest devised by the decedent to his widow. The Examiner raised the value of said property to $65,000.00 and, at the same time, struck out said particular marital deduction sought by plaintiffs, but instead allowed a marital deduction in the sum of $9,033.33, covering the

[14]Williams v. Howard, 31 S. W. 835; Norwood v. Farmers and Merchants National Bank, 145 S. W. 2d 1100; Goggans v. Simmons, 319 S. W. 2d 442.

amount of life insurance proceeds collected by the widow in the total of $8,333.33, and the value of the decedent's interest in the family automobile, being the additional sum of $700.00, which were treated as having passed to the widow outside of the decedent's will. The present issue is whether a marital deduction was erroneously denied in respect to the aforesaid real estate. This precise question here posed has no beaten track and calls for original determination. The position of the plaintiffs is that the devise of an undivided one-third part and interest in and to all the decedent's estate, both separate property and his one-half of the community property, necessarily included a one-third interest in the separate property real estate aforesaid, and that such interest obviously qualified for the purposes of a marital deduction. On the other hand, the Government contends that when the surviving widow elected to take under the will and relinquish her one-half interest and part of the community estate, she accepted an interest worth some less than what she relinquished and by this concatenation of circumstances wiped out any footing for a marital deduction in relation to the separate real estate of the decedent. To be more explicit, the contention is that what she received was worth $105,568.18 and what she relinquished was worth $111,442.68. Thusly, the Government seeks to uphold this factor in the total deficiency assessed against the executors.

The defendant first points out that preliminary to any advent of a marital deduction there must first be a transfer of property from the decedent to the surviving spouse,

which was includible in decedent's gross estate,[15] and such deduction, within the maximum limit[16] is allowable in an amount equal to the value of such transferred property, as provided by the statute already quoted in Footnote 15.

Next comes the critical part of the statute, Internal Revenue Code of 1939 §812(e)(1)(E)(ii), which reads as follows:

> "(ii) Where such interest or property is encumbered in any manner, or where the surviving spouse incurs any obligation imposed by decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."

Here ends the statutory chronicle and next begins the handiwork of the regulations.[17]

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[15]Internal Revenue Code of 1939, §812(e)(1)(A)

"For the purpose of the tax the value of the net estate shall be determined in the case of a citizen or resident of the United States, by deducting from the value of the gross estate—

* * *

(e) Bequests, etc. to surviving spouse

(1) Allowance of marital deduction—

(A) In General. An amount equal to the value of any interest in property which passes, or has passed, from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate."

[16]Internal Revenue Code of 1939 §812(e)(1)(H).

[17]Internal Revenue Code of 1939 §812(e)(1)(H)

Treasury Regulations 105, Sec. 81.47c(b), dealing with the subject of the marital deduction, in various aspects, states in part that the statutory reference to the passing of a property interest subject to the imposition of an obligation by the decedent includes a bequest in lieu of the interest of his surviving spouse under the community property laws, and then illustrates that particular ruling, as follows:

* * *

"(3) A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the state of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife."

Unless the illustration contained in the regulation just noted in the margin is a rational capsule of the underlying statute quoted above, there is no support for the Government's proposition. This illustration deals boldly with the interrelation of the marital deduction and community property, although nothing is said about community property in the specifically related statutory language. This is not to say that the Internal Revenue Code of 1939, in §812, is altogether silent in respect to community property, because such property is mentioned in that part of the section governing the computation of the adjusted gross estate, but is noticeably missing in that part of the section where the defendant plants its reliance for the authority of the quoted illustration published by the Commissioner.

Significantly, any reference to community property is likewise absent in the Senate Report No. 1013 on the Revenue Act of 1948, which was the origin of the presently pertinent provisions of §812 of the Internal Revenue Code of 1939, as amended, and the comment in that report directed to the very provision looked at by the regulation and illustration in question are here copied, as follows:

> "Clause (ii) of such Subparagraph (E) directs that in determining the value of any interest passing from the decedent to the surviving spouse, encumbrances or obligations shall be taken into account in the same manner as if the value of a gift to the spouse of the interest passing were being determined. This is a clarification which was not expressed in the Bill as passed by the House. If the decedent by his will leaves to his surviving spouse real estate subject to a mortgage (whether or not such mortgage was a personal liability of the decedent)

the value of the interest passing to the surviving spouse does not under this Section include the mortgage. If, however, the decedent by his will directs the executor to pay off the mortgage, such payment constitutes an additional interest passing to the surviving spouse. If the decedent bequeaths certain property to his surviving spouse subject, however, to her agreement, or a charge on the property for the payment of $1,000.00 to X, the value of the bequest (and, accordingly, the value of the interest passing to the surviving spouse) is the value reduced by $1,000.00, of such property." U. S. Congressional Service, 80th Congress, Second Session, 1948, Volume 2, pp 1163, 1227-8.

Such legislative declaration naturally has probative force to show that the intent of Congress, as equally well manifested in the words of the law, was to recognize certain contingencies which would be relevant to the value of property identified with the marital deduction. The contingencies pointed out in said Senate Report certainly would decrease pro tanto the equity value of the property in question, and Congress was concerned with guarding against a marital deduction based on an inflated valuation. The regulation and illustration already discussed distort the intent of the law and push things to an absurdity. The premise is that under the present will the widow, by electing to take under the will and relinquish her community interest, was a loser in the transaction. Even so, it is difficult to see what that has to do with the right of the plaintiff executors to claim the disputed marital deduction. Surely, the Government cannot mean to claim that because the widow was out more than she got that what she took under the will was worthless. This comes right to what

seems the fallacy in the position of the defendant because in talking about the value of the relinquished community estate an extraneous element is introduced. In the market place, the value of the property interest the widow acquired under the will would not depend in the least on what she gave for such property ownership. It would still be worth just as much as if she had acquired it at a bargain. In contract, if the interest going to her under the will of the decedent had been subject to a mortgage indebtedness, or an obligation in the nature of a charge to pay a given sum of money to some third person, such as were mentioned in the Senate Report, then, without doubt, such an item would be reflected as a minus factor in the valuation of the interest she took under the will, but that would be quite independent of whether she relinquished more or less than the value of the property left to her in the will. The defendant's contention is regarded as a compound of confusion and the regulations and accompanying illustration, against the background of this suit, are held to be an erroneous overgrowth of exposition.

The Government also has failed to come to grips with a latent quandary in the most prominent and explicit language of the governing statute, that is, the wording that "such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."

The Gift Tax Regulation, applicable to this lawsuit, in directing how to make valuation of gifts, as to property like that in the present estate, prescribes that such value is the

price at which such property would change hands between a willing buyer and a willing seller.[18]

The best counterpart which comes to mind in keeping with the statutory injunction to proceed "as if the amount of a gift to such spouse of such interest were being determined" is, if it be said that in an inter vivos transaction, the husband Stapf made a gift to his wife comprising a one-third interest in his whole estate, of both separate property and one-half of the community holdings, subject to the understanding that his wife, in turn, would make a gift of all her part of the community property and estate in trust for the children named as beneficiaries of the testamentary trust in Stapf's will. This supposed transaction presumably would entail a taxable gift by Stapf under the case of Commissioner v. Wemyss, 324 U. S. 303. To carry the similitude along, it should be assumed that such inter vivos gift from husband to wife was some less in value than the value of the community property she transferred in trust for the children. It would seem self-evident under the willing seller and willing buyer test that such gift property, being put to sale would have sold for none the less and none the more because of the value that the wife parted with in relinquishing her one-half of the community estate. Of course, to achieve the nearest likeness between the fictional gift transaction and this actual estate transaction, the gift of the one-third interest in the one instance and the devise of the one-third interest in the other instance are matching features, and manifestly, no contention of empty tax liability

[18]Reg. 108, Sec. 86.19.

could be made from the standpoint of the donor by saying that the gift property had no net value to the donee.

The marital deduction was fashioned to achieve better geographical equalization between citizens of the community property states and the non-community property states in the impact of estate and gift taxes, and undoubtedly it is an intricate expedient. There are a few cases which have decided close questions on this subject and in each instance the court upheld the right to the marital deduction.[19] It is well to recur to the policy of the marital deduction. That policy rests on the anticipation that the property used for the marital deduction and passing from the deceased spouse to the surviving spouse, though exempted from any tax in the estate of the deceased spouse, gains only a respite and not absolution, as such property will augment the estate of the surviving spouse and utimately make its contribution under the Estate Tax Law, or else in the meantime under the Gift Tax Law. This sequence would not be defeated if the plaintiffs are upheld in respect to the rejected marital deduction in the present estate. The one-third interest taken by this widow under the will of her deceased husband is valuable property, and unless disposed of by gift earlier, or used for living needs, should in ordinary course of time, after her death, be reported and inventoried in the estate tax return of her estate. In addition she, by her election under the will, became liable for a gift tax on the disparity in value between this marital

[19] United States v. Crosby, 257 S. W. 2d 514; Wachovia Bank & Trust Co. v. United States, 163 F. Supp. 832; Gwinn, Administrator v. Commissioner, 25 T. C. 31.

deduction property and her relinquished one-half of the community property estate.

The very spirit aforesaid of the law is the plain key to the statutory direction for valuation of marital deduction property and particularly the provision that "where such interest or property is encumbered in any manner or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."[20] This bespeaks a studied purpose of the law to guard against the allowance of a marital deduction in a sum greater than the net value of the property involved. Thus, property worth $10,000.00, but encumbered by a mortgage debt of $1,000.00, if devised to a surviving widow, will not rate a marital deduction of $10,000.00. It should sell for $9,000.00 encumbered, or if the widow pays out $1,000.00 to discharge the debt, it then should sell for $10,000.00, but in either event, the widow's estate is only augmented by $9,000.00. The statute demands a matching valuation between the marital deduction and the constituent property and any marital deduction over $9,000.00 in the illustration used would violate the statute. The significance in this case of what has just been said is to point up how far afield things went in summoning the one-half community interest relinquished by the widow to demolish the marital deduction claimed by the plaintiffs. This brought into play an element having no connection with the purpose of the

[20]Internal Revenue Code of 1939, §812(e)(1)(E).

law as discussed above, and was wholly irrelevant. Indeed, such denial of the marital deduction runs counter to the law for the consequence would be to tax at this time the interest devised by the decedent to his surviving spouse and then tax it again in later years as a part of her estate and this would simply reverse the purpose of the law in providing for a marital deduction. The crucial mistake made in denying the marital deduction was the premise that the decedent's will imposed an "obligation" on his widow within the sense of the relevant statute last quoted above. In reality, the will only tendered an option. There was nothing predetermined. The most that can be said is that the will stated a condition, in contrast to the imposition of any pecuniary obligation annexed directly to the property devised to the widow. In other words, that did not subject the widow to an "obligation" in the sense of the law for the reason that to conclude otherwise would be entirely pointless to the purpose of the law as already brought out above.

The right of the case on this issue is with the plaintiffs. In fact, the defendant is in the vulnerable position of relying on a regulation which, as read by the defendant, would be out of step with the apposite statute and, actually, the very regulation did not foreshadow any such application as now urged by the defendant. The defendant's rule of diminishing marital deductions to the point of zeroing out any marital deduction would even outdo the conventional law of diminishing returns in the political economy field. At least, no such outcome is spelled out in the regulation in question.

A judgment is directed in conformity with the directions and terms of this opinion.

GROSS ESTATE

"REGULATION 70, ARTICLE 10: Character of interests included. IX-33-4750 G.C.M. 7773

The husband, a resident of Texas, died leaving a will by which he devised to his wife and two children his entire separate estate together with the entire community estate owned by himself and wife. The wife elected to take under the will.

Held, that the interest which the wife has, under the laws of Texas, in the community estate is not a part of the deceased husband's gross estate within the meaning of section 302(a), Revenue Act of 1926, notwithstanding the wife elected to take under the will.

In the latter part of the year 1926, A, a resident of Texas, died testate, being surviving by his wife, B, and two children, C and D. At the time of his death A owned property which constituted his separate estate under the laws of Texas, and he and his wife, B, owned other property which constituted community property.

The pertinent provisions of A's will, in which he named B, C, and D as beneficiaries, are as follows:

I do hereby direct that all my just debts, funeral expenses, and expenses of my last sickness be paid by my executrix out of my estate as soon as practicable after my decease.

I do hereby give, devise and bequeath to the said B, my said wife, and to my children, C and D, share and share alike, all the rest and residue of my estate, real,

personal and mixed and of whatsoever kind and wherever situate, that I may own or in any way be entitled to or interested in at the time of my decease, including the entirety of the community property of myself and the said B, not merely my interest therein, and all my separate property and estate, to be theirs in equal shares in fee simple forever.

In the event the said B does not elect to take under this will, then I do hereby give, devise and bequeath all of my separate property and estate and all of my interest in the community property and estate of myself and my wife, B, to my children, C and D, share and share alike in fee simple forever.

B elected to take under the will.

The question presented is whether the interest which B had in the community estate under the laws of Texas and which was disposed of in the will is, under the provisions of section 302(a) of the Revenue Act of 1926, a part of A's gross estate.

A question similar to the one here involved was considered by the United States District Court for the Northern District of Texas in *Vincent v. United States* and *Underwood v. Reed.* The Vincent case was tried in the Fort Worth division, and judgment was rendered for the plaintiff on January 24, 1928. The Underwood case was tried in the Dallas division, and judgment was rendered in favor of the plaintiff on March 5, 1929. In each of those cases the court held without written opinion that the interest of the wife in the community estate was not a part of her deceased husband's gross estate. The Government did not appeal from those decisions.

In view of the court's decisions in the Vincent and Underwood cases, which are applicable to the instant case, it is the opinion of this office that the value of B's interest in the community property is not a part of A's gross estate within the purview of section 302(a) of the Revenue Act of 1926, notwithstanding the fact that she elected to take under the will.

All rulings of this office which are in conflict with this memorandum are hereby revoked.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue."

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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 54

UNITED STATES OF AMERICA, PETITIONER

v.

DOROTHY ANNE STAPF and B. T. WARE, II, Executors and Trustees of the Estate of LOWELL H. STAPF, Deceased, and DOROTHY ANNE STAPF, Individually

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the district court (R. 28-47) is reported at 189 F. Supp. 830. The opinion of the court of appeals (R. 64-96) is reported at 309 F. 2d 592.

JURISDICTION

The judgment of the court of appeals was entered on September 26, 1962 (R. 97-98). By order of Mr. Justice Stewart, dated December 21, 1962, the time for filing a petition for certiorari was extended to and including January 9, 1963 (R. 99). The petition for

certiorari was filed on January 9, 1963, and was granted on February 25, 1963 (R. 100; 372 U.S. 928). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether a devise of property to a surviving spouse on condition that she convey property of equal value to a third party entitles the decedent's estate to a marital deduction under § 812(e) of the Internal Revenue Code of 1939.

2. Whether obligations of a solvent community estate, half of which would otherwise be charged to the wife's half of the community property but which the decedent's will directs to be paid entirely from the half includible in his gross estate, are deductible in full from the decedent's gross estate as "claims against the estate" within the meaning of § 812(b)(3) of the Code.

3. Whether costs of administration chargeable to the wife's half of the community property but which the decedent's will directs to be paid out of his half are deductible from the decedent's gross estate as "administration expenses" under § 812(b)(2) of the Code.

STATUTES AND REGULATIONS INVOLVED

Sections 812(b), 812(e), and 1000 of the Internal Revenue Code of 1939; §§ 81.29, 81.32, 81.36, and 81.47c of Treasury Regulations 105 (1939 Code); and 86.2 of Treasury Regulations 108 (1939 Code) are set forth in part in the Appendix, *infra*, pp. 25-30.

STATEMENT

1. Lowell H. Stapf died on July 29, 1953, a resident of Texas. He was survived by his wife, Dorothy Anne Stapf. His will provided (R. 7):

> My estate consists of both separate and community property. It is my purpose, in making testamentary disposition of my estate, to dispose of my separate estate and to dispose of the entire community estate as though it were my separate property, and my wife is requested to take under this will and waive her right to one-half of the community property. In the event she does not elect to take under this will, then my interest in the community estate and my separate property shall be held [in trust for my children], * * * and my wife shall not receive any part of my interest in the community property or any interest in my separate property.

If she elected to take under the will, Mrs. Stapf was to receive the family automobile and one-third of the combined estate remaining after payment of a specific bequest of $5,000 to a son (R. 8, 14). The residue (after payment of debts, administration expenses, and taxes) was given in trust for the children (R. 8).

The debt-payment provision of the will directed the executors (R. 13-14):

> * * * to pay all and not merely one-half of the following debts and charges out of my one-half part and share of our community property and estate, to wit: [all debts, whether community or separate, all administration expenses, and all taxes] * * *. I direct that all property devised [to my wife] * * * shall pass under the terms of this Will free of all funeral expenses, costs of administration, debts of my estate, federal estate taxes and state inheritance taxes; provided, however, that in the event my wife, Dorothy Ann Stapf, does not elect to take under this Will, then one-half of all debts of my estate, funeral expenses and costs of administration shall be charged to the one-half share and

> part and portion of the community estate of my marriage with Dorothy Ann Stapf vested in the said Dorothy Ann Stapf in accordance with the laws of the State of Texas.

2. The decedent's separate property was valued at $65,000[1] and the community property at $258,104.54 (R. 53). The total amount of the debts, all of which were community debts, was $32,367.74. Administration expenses totalled $4,073.47 (R. 51).

Had Mrs. Stapf not elected to take under the will, her half of the community property ($129,052.27) would have been charged with one-half the community debts ($16,183.87) and 35% of the administration expenses ($1,425.72) (R. 54-55, 59, 66, n. 2). She would therefore have received $111,442.68.

Mrs. Stapf in fact elected to take under the will. Under the will, she received the automobile (valued at $1,400) and one-third of the combined estate remaining after the specific bequests ($105,568.18[2]), a total of $106,968.18.[3] Of that amount, the court of appeals treated $22,366.66 (one-third of the decedent's separate property; $21,666.66, plus his one-

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[1] Omitting $100 worth of tools that were the subject of a specific bequest and thus had no effect on the determination of Mrs. Stapf's share.

[2] The combined estate ($65,000 of separate property plus $258,104.54 of community property) totalled $323,104.54. The specific bequests of $6,400 ($5,000 to the son and the $1,400 automobile to the wife) reduced the estate to be divided to $316,704.54. One-third of that amount is $105,568.18 (see R. 54).

[3] The district court and the court of appeals included in the total amount received by Mrs. Stapf only $700 for the car, representing the decedent's one-half interest, and thus arrived at a total of only $106,268.18 (R. 54, 65). In fact, of course, Mrs. Stapf also retained her own one-half of the car, so that the correct figure is $106,968.18 as given in the text.

half of the community automobile, $700), as having passed from the decedent to Mrs. Stapf under the will and the balance of $84,601.52 (one-third of the community property remaining after the specific bequests) as coming out of her own half of the community property (R. 65, 71).[4] On that characterization of the amounts received by Mrs. Stapf, the consequence to her of electing to take under the will was that she gave up $26,841.16 of her own property,[5] allowing it to pass to the trust for the children under the terms of the will, and received $22,366.66 of her husband's property. By taking under the will, she thus suffered a net loss of $4,474.50.[6]

3. In its estate tax return, the decedent's estate claimed a marital deduction under § 812(e) of the Internal Revenue Code of 1939[7] for the full value of the decedent's property that passed to the wife under

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[4] In support of its characterization of Mrs. Stapf's receipts, the court of appeals cited two Texas state court decisions dealing with the applicability of state inheritance taxes to such a bequest (R. 71). For present purposes, we do not challenge either the court's conclusion that Mrs. Stapf's receipts would be so characterized for state law purposes or its assumption that that characterization would be controlling for federal estate tax purposes.

[5] *I.e.*, keeping only $84,601.52 of community property out of her interest worth $111,442.68.

[6] The net loss is of course the same if the comparison is made between the total amount Mrs. Stapf received upon electing to take under the will ($106,968.18) and the amount she would have received had she not ($111,442.68). The discrepancy between the net loss as we have computed it ($4,474.50) and the net loss as the lower courts computed it ($5,174.50, R. 54-55, 65) is due to their understatement by $700 of the value of the automobile she received (see note 3, *supra*).

[7] Unless otherwise indicated, all section references will be to the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.). The successor provisions of the 1954 Code are substantially identical.

the will ($22,366.66). It also claimed a deduction for the entire $32,367.74 of community debts as "claims against the estate" under § 812(b)(3), and for the entire $4,073.47 of expenses as "administration expenses" under § 812(b)(2).

The Commissioner of Internal Revenue disallowed the marital deduction[8] and the portions of the deductions for claims and administration expenses representing the debts (50%) and expenses (35%) attributable to the wife's half of the community property. The district court, in a suit for refund duly brought, upheld the partial disallowance of the claims and expense deductions but allowed the full marital deduction claimed by the estate (R. 59). The court of appeals, with Judge Wisdom dissenting on all issues (R. 74-96), held that all of the claimed deductions were allowable in full (R. 64-74).

SUMMARY OF ARGUMENT

I.

The first question is whether the decedent's bequest to his widow of property worth $22,367 on condition that she convey property worth $26,841 to the children entitles the estate to a $22,367 marital deduction under § 812(e) of the 1939 Code. That section allows a deduction for "the value of any interest in prop-

[8] Under the mistaken assumption that the specific bequest of the automobile to Mrs. Stapf was not conditioned upon her election to take under the will, the Commissioner actually allowed $700 of the claimed marital deduction, representing the decedent's half interest in the car. That allowance was not challenged in the district court and for that reason we do not here press for a reversal of the judgment below insofar as it allows that deduction (see R. 71, n. 5). To avoid confusion, however, we will in the argument use the correct figures.

erty which passes * * * from the decedent to his surviving spouse" but then directs that, in valuing the interest, if "the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such * * * obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined" (§ 812(e)(1)(E)(ii)). For gift tax purposes, in turn, it is obvious—and the regulations, copying from the committee reports, expressly so provide—that a transfer from *A* to *B* on condition that *B* convey property of equal value to *C* is a gift to *C*, not to *B*. (It is *C* who, for example, would be secondarily liable for the gift tax and whose status would determine the availability of a charitable deduction or of the annual exclusion.) There would be a gift to *B* only if (and only to the extent that) the value of the property he received exceeded the value of the property he was required to convey. It follows then, from the express terms of § 812(e)(1)(E)(ii), that for estate tax marital-deduction purposes the value of a conditional bequest to a spouse is the value of the property given to her less the value of the property she is required to give another to receive it. Since Mrs. Stapf was required to give up more than she got, that value is zero and the estate is entitled to no marital deduction.

That result is required also by the purpose of the marital deduction, which was solely to permit the "splitting" of estates between husband and wife and not to permit the transmission of wealth from one generation to the next free of either the gift or the estate tax, which is the admitted consequence of the decision below.

II.

The second question is whether the provision in the decedent's will directing his executors to pay all the community debts out of his half of the community property entitles the estate to deduct the entire amount of the debts under § 812(b)(3) as "claims against the estate * * * allowed by the laws of" the administering State. In the absence of the will, under Texas law the community debts would be charged equally against both halves of the community and, consequently, the estate would be entitled to a "claims" deduction for only one-half the community debts. The will cannot change the result. The very essence of a claim is that it is enforceable against the estate irrespective of the testator's wishes and thereby reduces the net value of the property over which he has testamentary power. Something that is payable by the estate only because the testator gratuitously directed its payment in his will is a legacy, not a claim. The law requiring its payment is not the law of the State governing the allowance of claims, but the law of the State governing the enforceability of wills. And even were it a claim it would be one founded upon a "promise or agreement" (the testator's consensual undertaking by his will) unsupported by adequate consideration and nondeductible for that reason.

III.

The administration expenses allocable to the wife's half of the community property, which the will similarly directed to be paid out of the decedent's half, were nondeductible for the same reason as the wife's share of the debts.

ARGUMENT

I.

A Testamentary Gift of Property to a Wife on Condition That She Convey Property of Her Own, of Equal or Greater Value, to a Third Party Is a Gift to the Third Party, Not to the Wife, and Does Not Qualify for the Marital Deduction

Mr. Stapf's will gave property worth $22,367 to his wife on condition that she convey property of her own worth $26,841 to a trust for the children created by the will. Mrs. Stapf elected to comply with the condition and thus suffered a net loss of $4,474. The question is whether the estate is entitled to a marital deduction under § 812(e) of the 1939 Code for the $22,367 so transferred to Mrs. Stapf, notwithstanding that it cost her $26,841 to receive it.

1. The marital deduction is allowed for "the value of any interest in property which passes * * * from the decedent to his surviving spouse" (§ 812(e)(1)(A)). In valuing the gift, the statute directs that, if "the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such * * * obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined" (§ 812(e)(1)(E)(ii)). An undertaking by the wife to convey property to a third person, upon which her receipt of property under the decedent's will is conditioned, is plainly an "obligation imposed by the decedent with respect to the passing of such interest." The question then is how such an obligation would be taken into account if the amount of an *inter vivos* gift to the spouse were being determined.

If *A* conveyed $4,000 to *B* on condition that *B* convey an automobile worth $4,000 to *C*, there is no doubt

that *A* would have made a gift, subject to the gift tax, in the amount of $4,000. The question the statute asks, however, is not the amount of the gift *by* the husband but the amount of the gift *to* the wife. Thus the relevant question, ignored by the court of appeals, is: who would be the *donee* of the gift, *B* or *C*? Who, for example, would be secondarily liable for the gift tax (§ 1009)? And whose status would determine the availability of the charitable deduction (§ 1004(a)(2)), of the annual exclusion (§ 1003(b)(3)), of the martial deduction (§ 1004(a)(3)), and of the privilege of having the gift deemed made one-half by *A's* spouse (§ 1000(f)(1))? Were *B* an automobile dealer and *C* a child of *A*, the answer could hardly be doubted. Not even the respondents would suggest that the automobile dealer, having simply sold a car and delivered it to the buyer's nominee, could be liable as donee for the gift tax, or that the father, having already made gifts exceeding $3,000 to his son, could claim a further annual exclusion by showing that he had made no prior gifts to the automobile dealer. The answer would be no less clear if *B* were a charity and *C* not, or *C* a charity and *B* not: the charitable deduction would be available in the latter case, not the former. Similarly, if *C* were *A's* wife, the gift would qualify for the martial deduction, while if *B* were, the gift would be to other than a spouse and the gift-splitting privilege would be available.

That the gift in every such case is to *C* and not *B* is self-evident, but authority, if wanted, is not lacking. The gift tax is expressly made applicable "whether the gift is direct or indirect" (§ 1000(b)), and the committee reports give as examples of "indirect" gifts transactions substantially identical to that involved

here (H. Rep. 708, 72d Cong., 1st Sess., pp. 27-28; S. Rep. 665, 72d Cong., 1st Sess., pp. 39-40):

> * * * (3) a transfer of property to B where there is imposed upon B the obligation of paying a commensurate annuity to C would be a gift to C; (4) the payment of money or the transfer of property to B in consideration whereof he is to render a service to C would constitute a gift to C or gifts both to B and to C depending on whether the service to be rendered by B to C was or was not an adequate and full consideration in money or money's worth for that which was received by B; * * *.

The gift tax regulations repeat those examples substantially verbatim. Regs. 108 (1939 Code), § 86.2(a) (Ex. 2 and 3).[9] Both the committee reports and the regulations thus leave no doubt that, in the gift accomplished by a transfer from *A* to *B* on condition that *B* transfer property of equal value to *C*, it is *C*, not *B*, who is the donee.

That conclusion is supported also by this Court's decision in *Helvering* v. *Hutchings*, 312 U.S. 393, holding that, for purposes of determining the number of "donees" and hence the number of annual exclusions, a gift to a trust is, not a single gift to the trustee, but several gifts to the several beneficiaries. The Court's rationale seems equally applicable to gifts through intermediaries other than trusts (see especially 312 U.S. at 396, drawing upon the above-quoted examples

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[9] The regulations add still another relevant example of a gift from *A* to *C*: *A*'s purchase of property with title being taken in *C*'s name (jointly with *A*, in the actual example) (Ex. 5). A transfer from *A* to *B* on condition that *B* convey property to *C* is in substance but *A*'s "purchase" of the property from *B* with directions that it be conveyed to *C*.

in the committee reports).[10] See also *Estate of Bartman* v. *Commissioner*, 10 T.C. 1073, 1080. That *C* is the donee of *A's* gift is also the necessary implication of the decisions of the lower courts that *B* is *not* liable for a gift tax on his transfer to *C* made as a condition to receiving a transfer from *A* (except, of course, to the extent that *B* gives more than he gets). *Commissioner* v. *Siegel*, 250 F. 2d 339 (C.A. 9); *Chase National Bank* v. *Commissioner*, 25 T.C. 617, reversed on other grounds, 259 F. 2d 231 (C.A. 5); cf. *Vardell's Estate* v. *Commissioner*, 307 F. 2d 688, 693 (C.A. 5); *Whiteley* v. *United States* (W.D. Wash.), decided February 28, 1963 (63-1 U.S.T.C. ¶ 12,145). *C*, the only one enriched by the transaction, is obviously in receipt of a gift from someone, and if *B* is not his donor, *A* must be.

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[10] *Commissioner* v. *Wemyss*, 324 U.S. 303, on which the court of appeals relied (R. 73), is not to the contrary. There a widow had an income interest in a trust that would terminate upon her remarriage (the interest succeeding to her child by the former marriage). To induce her to marry him, the taxpayer gave the widow securities in an amount sufficient to replace the income she would lose. The Court held that, since marriage (the only benefit flowing to the taxpayer) was not a consideration in "money's worth," the transfer of the securities was a taxable gift. But the Court did not decide (as it had no need to decide) that the taxpayer had made a gift *to the widow*, for it was plain enough that he had made a gift to someone, either to her or to the child. In the circumstances of that case, moreover, we think it would be quite correct to view the gift as having been to the widow; the reason is that, unlike here, the bargained-for consideration (albeit not qualifying as "money's worth" consideration for gift tax purposes) was the *marriage*, not the relinquishment of the trust interest (which followed merely as an unsought but unavoidable consequence of the marriage). Be that as it may, the Court's actual decision, limited to the existence of a taxable gift *vel non*, has no bearing on the issue here.

The committee reports, the regulations, and the cases thus all confirm the obvious: that a transfer from *A* to *B* on condition that *B* make a transfer to *C* is, to the extent of the equivalence in value of the transfers, a gift from *A* to *C*. There is a gift from *A* to *B* only to the extent that the transfer to *B* exceeds in value his transfer to *C*.

If that is the rule for gift tax purposes, then by the express terms of § 812(e)(1)(E)(ii) it is also the rule for estate tax marital-deduction purposes: the value of the interest passing to the wife is the value of the property given her less the value of the property she is required to give another as a condition to receiving it. And so the estate tax regulations provide, giving as an example the very kind of testamentary disposition involved in this case (a bequest conditional upon the wife's election to relinquish her interest in community property). Regs. 105, § 81.47c(b) (Ex. 1 and 3).[11] To conclude the matter, it should be sufficient to note that here, too, the regulations find specific support in the committee reports (S. Rep. 1013, 80th Cong., 2d Sess., Pt. 2, p. 6):

> If the decedent bequeaths certain property to his surviving spouse subject, however, to her agreement, or a charge on the property, for payment of $1,000 to X, the value of the bequest (and, accordingly, the value of the interest passing to the surviving spouse) is the value, reduced by $1,000, of such property.

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[11] The other example cited, equally in point, is that of a decedent's devise of a residence worth $25,000 to his widow "with a direction that she pay $5,000 to his sister." The value of the interest passing to the widow for marital deduction purposes is, according to the regulation, only the net value of $20,000.

2. What is apparent from the face of the statute is confirmed by brief reflection upon the purposes of the marital deduction and the "startling" possibilities produced by the decision below (see 76 Harv. L. Rev. 1671, 1673).

The purpose of the martial deduction was to extend to taxpayers in common-law jurisdictions the advantages of estate "splitting" previously enjoyed only by taxpayers in community-property jurisdictions—namely, the lower total tax resulting from the application of progressive estate-tax rates separately to two halves rather than to one whole.[12] The purpose being only to permit the property of a husband and wife to be taxed in two piles, and not to allow it to escape taxation altogether in the spouses' generation, it was of the essence that the deduction should be limited, as it was, to gifts to a spouse and then only if the interest given was of such a nature that it would be taxable in the spouse's estate (*i.e.*, not a "terminable" interest, § 812(e)(1)(B)).[13]

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[12] See H. Rep. No. 1274, 80th Cong., 2d Sess., pp. 24-26; S. Rep. No. 1013, 80th Cong., 2d Sess., pp. 26-29. The marital-deduction provision was added by the Revenue Act of 1948, 62 Stat. 110. For an earlier attempt to eliminate the discrimination by a different means (taxing the husband on all of the community), see § 402(b), Revenue Act of 1942, 56 Stat. 942; H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 35-37.

[13] See S. Rep. No. 1013, *supra*, p. 28; Warren & Surrey, *Federal Estate and Gift Taxation* (1961), pp. 759-760. Congressional preoccupation with the eventual taxibility of marital-deduction property in the surviving spouse's estate is exemplified by the exception (§ 812(e)(1)(F)) from the terminable-interest rule of a gift to a wife in trust for life with general power to appoint the remainder. Though the wife's interest in such property is qualitatively slightly inferior to a widow's title to half the community property, deduction was allowed on the ground that the property would, because of the general power of appointment, be taxable in her estate. See S. Rep. No. 1013, *supra*, p. 28; *id.*, Part 2, p. 16.

In allowing a martial deduction for the full value of property left a wife notwithstanding she is required, as a condition to receiving it, to convey property of equal value to the decedent's nominee, the decision below wholly corrupts the purpose of the martial deduction. Born a means to permit estate-splitting between spouses, it becomes a device by which any married person may remove one-half his estate from the reach of either the gift or the estate tax in either his or his wife's estate. Any decedent anywhere leaving a spouse surviving may dispose of his entire estate however and to whomever he pleases (*e.g.*, in trust for as many generations of descendants as the rule against perpetuities will permit), give nothing to his spouse (other than in exchange for property of equal value), and still make full use of the marital deduction so that only one-half his estate will be taxed.[14] All he need do to achieve that remarkable result is to preface the dispositive provisions of his will with a provision giving the property to his spouse "on condition" that

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[14] The only exception is a decedent having community property. The marital deduction is limited to one-half the "adjusted gross estate" (§ 812(e)(1)(H)) and that term excludes community property (§ 812(e)(2)), so that a marital deduction is available only if, and to the extent that, a decedent has separate property. The wife's half of the community property is, of course, excluded from the decedent's estate, but the property so excluded remains in the wife's estate and is subject to gift or estate taxes on its transmission to the next generation. Under the decision below, therefore, spouses in a common-law State can transmit up to one-half of their combined estate to the children free of tax while spouses in a community-property State cannot. That a provision designed to remove the discrimination in favor of community-property spouses should result in a discrimination against them is one of the minor anomalies produced by the decision below.

she convey property of equal value[15] in the manner directed by the remaining provisions.

The court of appeals acknowledged the surprising consequence of its decision that it permitted wealth to pass from one generation to the next without being subject to either of the transfer taxes (R. 73-74), but drew comfort from what promises to become the most distracting metaphor of modern tax litigation: "Granting * * * that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the congressional thumb, not the court's" (R. 74, n. 8). That Congress has a thumb does not justify a court in lightly assuming that it is all thumbs. The assumption must rather be that what Congress has done makes sense, and in this instance one who looks for sense in the statute has no difficulty finding it. Fairly read, § 812(e)(1)(F)(ii) requires that, in determining the value of the testamentary gift to Mrs. Stapf for marital-deduction purposes, the value of the property transferred to her ($22,367) must be reduced by the value of the property she was required to relinquish as a condition to receiving it ($26,841). Since that leaves a negative value,[16] the estate is entitled to no marital deduction.

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[15] Nor need the widow have property of her own to comply with the condition. Were an unpropertied widow left $100,000 on condition that she convey $100,000 worth of General Motors stock to her son, she could comply with the condition by using the $100,000 given her (or borrowing against it) to buy the required stock.

[16] The consequence, as the court of appeals recognized (R. 73), is that Mrs. Stapf was herself liable for a gift tax on the excess of the value of the property she relinquished in favor of the children over the value of the property received by her.

II.

A Provision in a Will Directing the Payment Out of the Decedent's Half of Community Property of Debts for Which the Wife's Half Is Equally Liable Is, as to the One-Half of the Debts Otherwise Chargeable to the Wife's Share, a Mere Legacy, and the Estate May Deduct as "Claims Against the Estate" Only the One-Half Chargeable to the Decedent's Share of the Community

Section 812(b)(3) of the Code provides that there shall be deducted from the value of the gross estate "Such amounts * * * for claims against the estate * * * as are allowed by the laws of" the administering State. The Stapfs' community property ($258,104) was subject to community debts of $32,367. Only one-half of the community property was includible in the decedent's estate and, in the absence of a will providing otherwise, only one-half of the community debts would be charged to his half. His will, however, directed his executors "to pay all and not merely one-half of the [community debts] * * * out of my one-half part and share of our community property" (R. 13).[17] The question is whether the estate was entitled, because of that provision, to deduct the entire amount of the com-

[17] Actually, the provision was conditioned upon Mrs. Stapf's election to take under the will (R. 14) and for that reason seems to have been wholly inoperative. The condition meant that the executors were to pay "her" debts only if she allowed a part of her share of the community *greater* than the debts to pass under the will. Nor did the provision in any way affect the distribution under the will: since her one-third share of the combined estate was to be determined before payment of the debts, which of the remaining assets were used for that purpose was a matter of indifference to her; and since the children got the residue of "her" share of the community as well as of "his", which share was charged with the debts could likewise have no effect upon what they got. The net effect of the provision was thus simply to change the labels on the dollars passing to the children: the executors were to use dollars labeled "his" to pay the debts, leaving fewer for the

munity debts as "claims against the estate." On that question (as, indeed, on the first) there is little that can be added to Judge Wisdom's scholarly dissent (see R. 74-85), and we need only briefly state the controlling considerations.

1. On the treatment of community debts in the absence of a contrary direction in a will, there is no disagreement between the majority and dissenting opinions in the court of appeals, between the court of appeals and the district court (reversed on this issue), or, we believe, between the parties.

Community debts are primarily the obligation of the community, chargeable equally against both halves upon its dissolution. The husband, as manager of the community, is also personally liable for the debts while the wife is not, but his liability is, as between him and the community, only that of a surety. If he pays community debts with his separate property, voluntarily or involuntarily, he is entitled to reimbursement from the community, the primary obligor. *Snodgrass* v. *Robertson*, 167 S.W. 2d 534 (Tex. Civ. App.). If, then, Stapf's will had made no provision for debt pay-

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children, provided she conveyed enough "her" dollars to the children to make up for the reduction.

The inconsequence of the provision was, however, overlooked by the court of appeals, and in order to deal with the question in the terms in which it was decided by the court of appeals, we will assume that the provision was not contingent upon Mrs. Stapf's taking under the will. Had she not taken under the will and the executors had nevertheless paid the entire community debts, the effect would have been to give her $129,052 of the community property rather than the $111,442 she would have taken in the absence of the provision ($129,052 less her share of the community debts and administration expenses, $17,609). It is in terms of a debt-payment provision with those substantive consequences (rather than the mere labelling provision actually involved in this case) that the discussion in text is cast.

ment, the probate court, in determining the distribution of the community property as between the decedent's devisees and Mrs. Stapf, could have charged only one-half of the community debts against the decedent's half of the community property. Only if the community were insolvent (not the case here) could the decedent's estate (and thus his devisees) be made to bear the burden of more than one-half the debts. *Clark* v. *First National Bank*, 210 S.W. 677, 679 (Tex. Com. App.); see also R. 69 (majority opinion), 76-79 (dissenting opinion).

No less clear than the law of Texas are the tax consequences flowing from it. Since Texas law would "allow" only one-half the community debts against the decedent's estate, only one-half the debts would be deductible as "claims against the estate * * * allowed by" State law (§ 812(b)(3)). And so the courts and commentators have uniformly held.[18] Even if, because of the husband's personal liability as manager of the community, his estate were directly suable as a procedural matter, the estate's rights of recourse against the solvent community would bar any claims deduction for more than one-half the debts.[19]

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[18] *Lang's Estate* v. *Commissioner*, 97 F. 2d 867 (C.A. 9), affirmed on other issues, 304 U.S. 264; *Claiborne* v. *Commissioner*, 40 B.T.A. 722; see *Schoenfeld* v. *Commissioner*, 103 F. 2d 964 (C.A. 9); 4 Mertens, *Federal Gift and Estate Taxation* (1959), Sec. 26.20; Warren & Surrey, *Federal Estate and Gift Taxation* (1961), p. 710; Lowndes and Kramer, *Federal Estate and Gift Taxes* (1962), Sec. 15.18; cf. *Stewart* v. *Commissioner*, 63 F. 2d 62 (C.A. 5), certiorari denied, 284 U.S. 658.

[19] Cf. *Parrott* v. *Commissioner*, 30 F. 2d 792 (C.A. 9), certiorari denied, 279 U.S. 870 (joint and several liability on mortgage note); *DuVal's Estate* v. *Commissioner*, 152 F. 2d 103 (C.A. 9), certiorari denied, 328 U.S. 838 (co-guarantor); *Towner* v. *Commissioner*, 182 F. 2d 903 (C.A. 2), certiorari denied, 340 U.S. 912 (accommoda-

2. The only dispute then is over the effect of the will. Does the will's direction to the executors to pay the wife's half of the community debts as well entitle the estate to deduct the entire community debts as "claims against the estate * * * allowed by" State law? Patently not. The very essence of a "claim" is that it is enforceable against the estate irrespective of the debtor's wishes and thus reduces the net value of the property over which the decedent has testamentary power. An amount payable by the estate only because the decedent directed his executors so to distribute his wealth is no "claim" at all, certainly not one "against the [decedent's] estate." Such a provision, as Judge Wisdom aptly described it (R. 76), is but a "straight pecuniary legacy" to the person whose debts are to be paid.

Nor is it relevant that the law of the State would enforce the provision. In permitting deductions for "claims against the estate * * * allowed by" State law, the Code's reference is to the State's law governing the allowance of claims—*i.e.*, the compelled payment of claims enforceable against the estate without regard to the testator's will—and not the law governing the validity and enforceability of wills. It was only under the latter law that the payment of Mrs. Stapf's half

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tion maker); *Estate of Cabot* v. *Commissioner*, 46 B.T.A. 225 (guarantor); *Estate of Atkins* v. *Commissioner*, 2 T.C. 332 (co-maker); *Sample* v. *United States* (W.D. Pa.), decided March 9, 1961 (61-1 U.S.T.C., ¶ 12,004) (joint federal income tax liability). As the *Parrott* and *Atkins* cases recognize, the effect is the same if the "claims" deduction is allowed in full to the secondary obligor's estate and the value of the right of recourse against the primary obligor is included in the gross estate as "property" of the decedent's (§ 811(a)). Either way, the taxable estate is not reduced unless the primary obligor is insolvent.

of the community debts out of the decedent's property was enforceable.

Finally, allowance of the deduction here would be inconsistent with the provisions of § 812(b) allowing a deduction for claims founded on a "promise or agreement" only if contracted "for an adequate and full consideration in money or money's worth." The transaction that is relevant is not the transaction by which the community became liable (as the court of appeals suggested, R. 70), but the transaction by which the decedent's estate became liable to pay the entire debts of the community without recourse to the wife's half of the community. The duty of the estate to pay all the debts was imposed, in turn, not by law, but by the decedent's undertaking in his will, which in no relevant respect is different from an *inter vivos* "promise" equally unsupported by adequate consideration.[20] The purpose of the adequate-consideration limitation on the claims deduction was to prevent testamentary dispositions from being made as deductible "claims" through the device of gratuitous, if binding, promises. See S. Rep. 398, 68th Cong., 1st Sess., p. 35; H. Rep. 179, 68th Cong., 1st Sess., p. 28. It would indeed be anomalous if, adequate consideration being lacking in both cases, a binding *inter vivos* commitment did not give rise to a deductible claim but an ambulatory direction in a will did.

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[20] We are assuming here, as did the court of appeals, an unconditional direction to pay the debts (see p. 17, n. 17, *supra*). Where the executors are told to pay the wife's share of the debts only if she conveys property of equal value to the children (the actual case), there is "consideration" for the payment but the payment is even more obviously not a satisfaction of a pre-existing "claim"; it amounts simply to a "purchase" of other assets with which to effect a testamentary gift to the children. See Point I, *supra*.

III.

The Administration Expenses Chargeable Under State Law to His Wife's Half of the Community Property Were Not Deductible from the Decedent's Gross Estate Notwithstanding the Will Directing Their Payment

The expenses of administering the combined estate (consisting of both the community property and the decedent's separate property) were $4,073. Under Texas law an allocable share of those costs (determined to be $1,425) was chargeable to Mrs. Stapf's half of the community property. *Norwood* v. *Farmers & Merchants Nat. Bank*, 145 S.W. 2d 1100 (Tex. Civ. App.); see *Goggans* v. *Simmons*, 319 S.W. 2d 442 (Tex. Civ. App.). Stapf's will, however, directed that all the administration expenses be paid out of his half of the community property. The question is whether their payment under that provision made the wife's share of the costs deductible by the estate as "administration expenses * * * allowed by the laws of" the State under § 812(b)(2) of the Code.

That question is substantially identical to that of the deductibility of the community debts discussed in Point II. As their enumeration together in § 812(b) suggests, "claims" and "administration expenses" have a common character as deductions: both are liabilities of the estate that reduce the net value of the property subject to testamentary disposition. They differ only in the formal respect, irrelevant here, that "claims" are liabilities existing at the date of death while "administration expenses" are liabilities incurred in administering the estate. If, therefore, the share of the community debts chargeable to Mrs. Stapf's half of the community property were not "claims against the estate" within the meaning of

§ 812(b)(3), it follows for the same reasons that the administration costs chargeable to her half of the property were not "administration expenses" of the estate within the meaning of § 812(b)(2). They are accordingly not deductible. See *Lang's Estate* v. *Commissioner, supra; Estate of Lee* v. *Commissioner*, 11 T.C. 141; *Schuhmacher* v. *Commissioner*, 8 T.C. 453; *Levy* v. *Commissioner*, 42 B.T.A. 991.[21]

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed.

Respectfully submitted,

ARCHIBALD COX,
Solicitor General.

LOUIS F. OBERDORFER,
Assistant Attorney General.

WAYNE G. BARNETT,
Assistant to the Solicitor General.

ROBERT N. ANDERSON,
Attorney.

AUGUST 1963.

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[21] *Blair* v. *Stewart*, 49 F. 2d 257 (C.A. 5), holding a decedent husband's funeral expenses deductible in full from his estate, is not contrary in principle. That holding was based on the court's belief that under Texas law funeral and administration expenses were chargeable in their entirety against a decedent husband's estate rather than against the community as a whole—an assumption which has since been expressly repudiated by the Texas courts. See *Norwood* v. *Farmers & Merchants Nat. Bank, supra.*

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C. 1952 ed.)

SEC. 812. NET ESTATE.

For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

* * *

(b) [as amended by Sec. 405(a), Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 502, Revenue Act of 1950, c. 994, 64 Stat. 906] *Expenses, Losses, Indebtedness and Taxes.*—Such amounts—

(1) for funeral expenses,

(2) for administration expenses,

(3) for claims against the estate, and

(4) for unpaid mortgages upon, or any indebtedness in respect to, property where the value of decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,

as are allowed by the laws of the jurisdiction, whether within, or without the United States, under which the estate is being administered, but not including any income taxes upon income received after the death of the decedent, or property taxes not accrued before his death, or any estate, succession, legacy, or inheritance taxes. The deduction herein allowed in the case of claims against the estate, unpaid mortgages, or any indebtedness shall, when founded upon a promise or agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth; * * *

* * *

(e) [as added by Sec. 361(a), Revenue Act of 1948, c. 168, 62 Stat. 110] *Bequests, Etc., to Surviving Spouse.*—

(1) *Allowance of marital deduction.*—

(A) *In General.*—An amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

* * *

(E) *Valuation of Interest Passing to Surviving Spouse.*—In determining for the purposes of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—

* * *

(ii) where such interest or property is encumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

* * * * *

SEC. 1000. IMPOSITION OF TAX

(a) For the calendar year 1940 and each calendar year thereafter a tax, computed as provided in section 1001, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift. * * *

(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; * * *.

Treasury Regulations 105 (Estate Tax, 1939 Code)

SEC. 81.29. *Deduction of administration expenses, claims, etc.*—In order to be deductible under the foregoing provisions of the Internal Revenue Code, the item must fall within one of the several classes of deductions specifically enumerated therein, and must also, except in the case of deductible losses during the administration of the estate, be one the payment of which out of the estate is authorized by the laws of the jurisdiction under which the estate is being administered. Unless both of these conditions exist the item is not deductible. If the item is not one of those described it is not deductible merely because payment is allowed by the local law. If the amount which may be expended for the particular purpose is limited by the local law no deduction in excess of such limitation is permissible. If a claim against the estate, an unpaid mortgage, or an indebtedness is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. * * *

* * *

SEC. 81.32. *Administration expenses.*—The amounts deductible from the gross estate as "administration expenses" are such expenses as are actually and necessarily incurred in the administration of the estate; that is, in the collection of assets, payment of debts, and distribution among the persons entitled. The expenses contemplated in the law are such only as attend the

settlement of an estate by the legal representative preliminary to the transfer of the property to individual beneficiaries or to a trustee, whether such trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions. Administration expenses include (1) executor's commissions; (2) attorney's fees; (3) miscellaneous expenses. * * *

* * * *

SEC. 81.36. *Claims against the estate.*—The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, whether or not then matured, and interest thereon which had accrued at the time of death. * * * Only claims enforceable against the decedent's estate may be deducted. If the claim is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. * * *

* * * *

SEC. 81.47c. [as added by T. D. 5699, 1949-1 Cum. Bull. 181, 206]. *Valuation of property interest passing to surviving spouse.*— * * * (b) *Property interest subject to an incumbrance or obligation.* Section 812 (e)(1)(E) provides that where a property interest passed from the decedent to his surviving spouse subject to a mortgage or other incumbrance, or where an obligation is imposed upon the surviving spouse by the decedent in connection with the passing of a property interest, the value of such property interest is to be reduced by the amount of such mortgage, other incumbrance, or obligation. The passing of a property interest subject to the imposition of an obligation by the decedent does not include a bequest, devise, or transfer

in lieu of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy or of other marital rights in the decedent's property or estate. The passing of a property interest subject to the imposition of an obligation by the decedent does, however, include a bequest, etc., in lieu of the interest of his surviving spouse under community property laws unless such interest was, immediately prior to the decedent's death, a mere expectancy. * * *

The following are illustrative of property interests which passed from the decedent to his surviving spouse subject to the imposition of an obligation by the decedent:

(1) A decedent devised a residence valued at $25,000 to his wife, with a direction that she pay $5,000 to his sister. For the purpose of the marital deduction, the value of the property interest passing to the wife is only $20,000.

* * * * *

(3) A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife.

* * * * *

Treasury Regulations 108 (Gift Tax, 1939 Code)

SEC. 86.2 [as amended by T.D. 5902, 1952-1 Cum. Bull. 167]. *Transfers reached.*—(a) *In general.*—The statute imposes a tax whether the transfer is in trust or otherwise, whether the gift is direct or indirect,

and whether the property is real or personal, tangible or intangible. * * * Inasmuch as the tax also applies to gifts indirectly made, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax. * * * In the following examples of transactions resulting in taxable gifts, it will be understood that the transfers were not made for an adequate and full consideration in money or money's worth:

* * * * *

(2) The transfer of property to B where there is imposed upon B the obligation of paying a commensurate annuity to C is a gift to C.

(3) The payment of money or the transfer of property to B in consideration whereof B is to render a service to C, is a gift to C, or both to B and C, depending on whether the service to be rendered by B to C is or is not an adequate and full consideration in money or money's worth for that which is received by B.

* * * * *

(5) If A with his own funds purchases property and has the title thereto conveyed to himself and B as joint owners, with rights of survivorship (other than a joint ownership described in example (4) of this section), but which rights may be defeated by either party severing his interest, there is a gift to B in the amount of one-half the value of such property.

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No. 54

In the

Supreme Court of the United States

OCTOBER TERM, 1963

UNITED STATES OF AMERICA,

Petitioner,

v.

DOROTHY ANNE STAPF AND B. T. WARE, II, Executors and Trustees of the ESTATE OF LOWELL H. STAPF, Deceased, AND DOROTHY ANNE STAPF, Individually,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR THE RESPONDENTS

W. M. SUTTON,
H. A. BERRY,
JERRY F. LYONS,
WINSTON R. SMITH,
P. O. Box 550,
Amarillo, Texas,
Attorneys for Respondents.

Of Counsel:

UNDERWOOD, WILSON, SUTTON,
HEARE & BERRY
P. O. Box 550,
Amarillo, Texas.

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No. 54

In the

Supreme Court of the United States

OCTOBER TERM, 1963

UNITED STATES OF AMERICA,

Petitioner,

v.

DOROTHY ANNE STAPF AND B. T. WARE, II, Executors and Trustees of the ESTATE OF LOWELL H. STAPF, Deceased, AND DOROTHY ANNE STAPF, Individually,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR THE RESPONDENTS

OPINIONS BELOW

The opinion of the District Court (R. 28-47) is reported at 189 Fed. Supp. 830. The opinion of the Court of Appeals (R. 64-96) is reported at 309 Fed. 2d 592.

JURISDICTION

Respondents do not deny or question jurisdiction.

QUESTIONS PRESENTED

Respondents submit that the questions presented are more accurately stated as follows:

1. Should the agreed value of property, passing to the surviving spouse under the will of the decedent and otherwise qualifying for the marital deduction, be reduced to zero in determining the estate tax liability of the decedent's estate because the surviving spouse exercised an option, as she was authorized to do under the decedent's will, in effect giving to the trustees of a testamentary trust, for the children of the decedent and the surviving spouse, an undivided interest in a part of her fully vested share of the community property of a greater value than the property passing under the will to the surviving spouse?

2. Whether claims against the community estate, which the decedent's will directs be paid entirely from his half of the community estate, are deductible in full from the decedent's gross estate within the meaning of Section 812(b) of the Revenue Code of 1939, as amended, or if not so deductible under such section, should, to the extent the will requires the portion of the debts, as would otherwise be chargeable to the survivor, be paid from the decedent's estate and not that of the surviving spouse, be treated as additional bequests to the surviving spouse qualifying for the marital deduction?

3. Whether costs of administration to the extent otherwise chargeable to the survivor, which the decedent's will directs to be paid entirely from his half of the community estate,

are deductible in full from the decedent's gross estate within the meaning of Section 812 (b) of the Revenue Code of 1939, as amended, or if not so deductible under such section, should, to the extent the will directs such debts to be paid from the decedent's estate and not that of the surviving spouse, be treated as additional bequests to the surviving wife, qualifying for the marital deduction?

STATUTES AND REGULATIONS INVOLVED

Section 812(b) and 812(e) of the Internal Revenue Code of 1939, as amended (26 U.S.C. 1952 Ed.) and Sections 81.36, 81.47a, and 81.47c of Treasury Regulations 105 are set forth in part in App. A, Infra, pp. 1a to 5a.

Unless otherwise noted, references will be to the 1939 Internal Revenue Code, as amended.

STATEMENT

This is an action for a refund of estate taxes allegedly erroneously assessed and paid. The facts are stipulated. Two claims of the respondent taxpayers for refund, both of which were allowed by the Court of Appeals, are presented for review by the granting of the Government's Petition for Certiorari:

1. The claim of respondent taxpayers that the Commissioner erred in reducing to zero, in determining the marital deduction, the value of identifiable property passing to the surviving spouse under the will of the decedent and other-

wise qualifying for the marital deduction, because the surviving wife elected to take under the will, which disposed of the entire community estate, and as a result of the exercise of the option granted to her received from her deceased husband, under his will, and retained by her out of her community estate less than she would have retained out of her community property had she elected not to take under the will. The District Court (R. 28, 40-47) held for the taxpayer that the value of the property passing to the surviving spouse under the will of the decedent should not be so reduced in determining the marital deducting as a result of such facts. The Government appealed from such portion of the judgment of the District Court and the Court of Appeals for the Fifth Circuit affirmed such portion of the pudgment of the District Court and held for the taxpayer thereon (R. 64, 71-74). Judge Wisdom dissented.

2. The claim of the respondent taxpayers that the Commissioner erred in refusing to allow, as a deduction from the gross estate in determining the taxable estate, the full amount of administration expenses of the estate of the decedent and the full amount of claims against the entire community estate, all of which the will of the decedent directed to be paid out of his portion of the community property and his separate estate. The District Court held for the Government and against the taxpayers upon such issue (R. 28, 32-40). The respondent taxpayers appealed from such portion of the trial court's judgment to the Court of Appeals

for the Fifth Circuit. The Court of Appeals held for the taxpayers and reversed the District Court on such issue (R. 64-71). Judge Wisdom dissented.

Initially, an additional claim for refund based on the error of the Commissioner of including in the gross estate of decedent a portion of life insurance proceeds not properly includable was presented. The District Court held for respondent taxpayers on such issue (R. 28, 31). The Government did not appeal from the determination of such issue by the trial court but conceded the correctness of such conclusion in Note 3, p. 9, of its brief as Appellant in the Court of Appeals.

Lowell H. Stapf died July 29, 1953, a resident of Texas, and was survived by his wife, Dorothy Anne Stapf (R. 48). His estate, exclusive of life insurance, consisted of certain real property in the city of Amarillo, Texas, of the agreed value of $65,000.00 and certain hand tools of the agreed value of $100.00 (R. 54), which constituted his separate property and estate. Additionally, he owned with his wife community property of the gross value of $258,104.54 (R. 53, 54-55). The total amount of debts, all of which were community debts, was $32,367.74 (R. 51, 55, 65). Administration expenses totaled $4,073.47 (R. 51).

Section I of the will of the decedent, Lowell H. Stapf (R. 7), disposed of not only the separate property of the decedent but the entire community and requested his wife to take under the will and waive her right to one-half of the community property. The will provided that if she did not

elect to take under the will that she would receive no interest in the separate property of the decedent.

Section III of the will (R. 8) contained a special devise of $5,000.00 and personal machinist's hand tools of the value of $100.00 (R. 50, 54) to decedent's son, Lowell H. Stapf, Jr. Section IV of the will devised to Dorothy Anne Stapf the family automobile and one-third of the residue of the total estate after the bequest to Lowell Stapf, Jr. and the family automobile to Mrs. Stapf (R. 8). The family automobile was community property and had a total value of $1400.00 (R. 53, 54). Sections V, VI, VII and VIII of the decedent's will (R. 8-12) devised the residue of the estate remaining after satisfying the special bequests to Lowell Stapf, Jr., and to the surviving wife, Dorothy Anne Stapf, to B. T. Ware, II, and Dorothy Anne Stapf, Trustees in trust for the benefit of Lee Dale Stapf, Donald Eric Stapf and Sylvia Rose Stapf.

Section XII of the decedent's will (R. 13-14) directed the executors to pay all of and not merely one-half of all funeral expense, costs of administration, taxes and debts out of the decedent's one-half community estate and separate property and provided that no part of such debts and expenses should be charged against the one-half share of the surviving wife in the community property. Such section further provided that if the surviving spouse did not elect to take under the will the debts of the estate, funeral expenses and costs of administration should be charged against the one-half community estate of Dorothy Anne

Stapf and the one-half community estate of the decedent in accordance with the laws of the State of Texas.

Had Mrs. Stapf not elected to take under the will, her one-half of the community property ($129,052.27) would have been charged with one-half of the community debts ($16,183.87) and 35% of the administration expenses ($1,425.72) (R. 54-55, 59, 66 N. 2), and she would have retained her fully vested community property of a net value of $111,442.68 (R. 55, 65).

Mrs. Stapf elected to take under the will after the death of her husband and the offer of his will to probate. Under the will she received from her husband, one-third of the decedent's separate property remaining after the special devise of hand tools was satisfied of a total valuation of $65,000.00 and his one-half interest in the autmobile. Thus she received $21,666.66 of decedent's separate property plus the decedent's one-half interest in the community automobile of a value of $700.00, or the total amount of $22,366.66. Additionally, Mrs. Stapf retained her one-half interest in the family automobile and one-third of the residue of the community property remaining after satisfying the special bequest to Lowell Stapf, Jr., and to Mrs. Stapf, of a total value of $106,268.18, as computed by the District Court and Court of Appeals (R. 54, 65), or $106,968.18 if computed as petitioner has computed the amount on page 4 of its brief.

By her election, Mrs. Stapf surrendered to the trustees for the benefit of the beneficiaries the difference between the portion of the community estate retained by her after

she had exercised her election, to wit, $83,901.52 (R. 54)[1], and the net amount that she would have retained had she elected not to take under the will of the decedent, to wit, $111,442.68, or a difference of $27,541.16 (R. 65), as determined by the District Court and the Court of Appeals. Petitioner computes the amount Mrs. Stapf gave to the trustees for the benefit of her children to be $26,841.16 (Pg. 5 of brief). The exact amount is immaterial for our present purposes.

In its estate tax return the decedent's estate claimed a marital deduction under Section 812(e) of the Internal Revenue Code for the full value of the decedent's property (one-third interest in the lots in the city of Amarillo and one-half interest in the family automobile of the aggregate value of $22,366.66) that passed to the surviving wife under the will of the decedent. The estate additionally claimed a deduction for the entire $32,367.74 of community debts as "claims against the estate" under Section 812(b)(3) and for the entire $4,073.47 of expenses as "administration expenses" under Section 812 (b)(2).

The Commissioner of Internal Revenue disallowed the marital deduction and the portions of the deductions for

[1]If the will had not provided and required that the debts and expenses of administration, otherwise chargeable to Mrs. Stapf's share of the community, be charged against and paid out of Mr. Stapf's share of the community or had not provided for Mrs. Stapf to receive ½ of the gross estate (less bequests), undiminished by debts and expenses, then the part Mrs. Stapf would have retained from her part of the community would have been reduced by the sum of $17,609.59 (the amount of debts and expenses that would have been chargeable to her portion of the estate but for the will provisions) or the sum of $66,292.93. Mr. Stapf effectively made an additional testamentary bequest to Mrs. Stapf of $17,609.59 by assuming and directing the payment of these debts and expenses out of his part of the total estate and excusing Mrs. Stapf's property from such charges.

claims and administration expenses representing the debts (50%) and the expenses (35%) attributable to the wife's half of the community property. As first noted in this statement, the District Court allowed the full marital deduction claimed by respondent taxpayers but upheld the disallowance of claims and expenses (R. 59). The Court of Appeals (R. 74) uphold both claims asserted by respondent taxpayers.

SUMMARY OF ARGUMENT

I. Marital Deduction

This case only relates to the quantum of liability of the decedent's estate for estate taxes. The question of the liability and extent of liability of the surviving spouse for gift taxes as the result of her gift of her community property to the trustees for the benefit of the children is not involved or presented for decision. As the result of the exercise of her option to take under the will of Mr. Stapf, two events occurred:

1. One-third interest in the separate property of Mr. Stapf and his one-half interest in the family automobile passed absolutely to Mrs. Stapf. The total value of the property and property interests so passing is $22,366.66. Such property so passing meets all of the requirements of Section 812(e) of the Revenue Code of 1939 and is deductible as a marital deduction in determining the ultimate estate tax liability.

2. Mrs. Stapf surrendered or gave to the trustees for the benefit of the children, absolutely, an undivided interest in

her one-half of the community property represented by the difference between ½ of the net community estate and ⅓ of the gross estate. This difference is $26,841.16 according to the Government's calculations.

The property passing to Mrs. Stapf under the will fully qualifies for the marital deduction since all requirements of Section 812(e) are met. The act of the Commissioner in refusing to allow the marital deduction by reducing the value of such property to zero because Mrs. Stapf, as a result of the exercise of her option to take under the will, gave to her children property of greater value is contrary to and violates the provisions of the marital deduction statute. The regulations of the Commissioner authorizing such action are an unauthorized and unwarranted extention of the statute and go beyond the language, purpose and intent of such act, and are contrary to the applicable law as announced by this Court in *Commissioner v. Wemyss, 324 U. S. 303.*

To contend, as the Government contends, that Mr. Stapf, but not Mrs. Stapf, actually or constructively, made a gift to the trustees for the benefit of the children ignores what actually occurred and, as determined by both the District Court and Court of Appeals, is contrary to both the facts and the established applicable law as determined by this Court in decision in *Commissioner v. Wemyss, 324 U. S. 303*, and the requirements of Section 812(e).

If the position of the Government is sustained, the effect will be to subject the $22,366.66 of property passing to Mrs. Stapf under the will of Mr. Stapf to estate taxes twice.

Once in Mr. Stapf's estate and again in Mrs. Stapf's estate, should she die possessed of it, contrary to the purpose and intent of Section 812(e) that property so passing and qualifying for the marital deduction should be subjected to only one estate tax. The Government's position would effectively tax (to the extent of the value of the property passing to Mrs. Stapf) the gift of Mrs. Stapf to the trustees under the estate tax statute but not under the gift tax statute and at estate tax rates rather than at gift tax rates to which her gift is properly subject.

II and III. The Deduction for Claims Against the Estate and Administration Expenses

Under Section 812(b) of the Internal Revenue Code, debts and expenses, which are deductible in determining the net estate for estate tax liability, are those allowed by the laws of the jurisdiction under which the estate is being administered. Thus, the laws of Texas, which permit a testator, by the terms of his will, to charge all debts and expenses against his portion of the estate, should be given effect and such debts and expenses should be allowed as deductions in their entirety as directed by the will of the decedent in determining the estate tax liability of the decedent's estate.

If the debts and expenses, otherwise chargeable to Mrs. Stapf's part of the community and which the will orders be paid out of Mr. Stapf's estate, are not deductible in his estate under Sec. 812(b), then the amount thereof qualifies for the marital deduction and should be deducted from

decedent's gross estate under Sec. 812(e) to the extent that such amounts when added to the other amounts qualifying for the marital deduction, do not exceed 50% of the value of the "adjusted gross estate" under Sec. 812(e)(1)(H). This is true because, to the extent that the decedent assumed and ordered paid out of his estate debts and expenses that would have otherwise been charged to Mrs. Stapf, the decedent made a testamentary gift that qualifies for the marital deduction provisions of Sec. 812(e).

ARGUMENT

I

The opinions and judgments of the District Court and the Court of Appeals are correct in holding that the separate and community property of the decedent, passing to surviving wife under the husband's will, qualified for the marital deduction and that the value thereof should not be reduced because the surviving wife, by the exercise of the option granted under the will gave, to the trustees for the benefit of her children, a portion of her one-half interest in the community property of a greater value than the property passing to her under the will of her husband.

We are concerned here only with the estate tax liability of Mr. Stapf's estate. The liability of Mrs. Stapf for gift taxes with respect to the property interest given to the trustees for the benefit of her children out of her part of the community property, and never included in her husband's estate, is not presented for decision. Mrs. Stapf has

never denied the gift tax consequences of her gift, but such consequences are not in issue in this case.

As determined by both the District Court and Court of Appeals and as admitted by the Government (page 5, Note 4 of brief), the property that passed to Mrs. Stapf under the will of Mr. Stapf was a one-third interest in his separate property (consisting of real property in Amarillo, Texas) and his one-half community interest in the family automobile of the aggregate agreed value of $22,666.66. It is conceded by the Government (page 5, Notes 4 and 5), as determined by the Court of Appeals (R. 71), that under Texas law the devise of one-third of the whole community to Mrs. Stapf did not pass to her under the will of the decedent but was satisfied out of her own one-half of the community property. *Jones v. State, Texas Comm. of App. 1928, 5 S. W. 2d 973*, and *Calvert, Comptroller, v. Fort Worth National Bank, Texas Supreme Court 1962, Tex. , 356 S. W. 2d 918.* By her election, Mrs. Stapf gave to the trustees for her children the difference between her one-half interest in the community estate which was fully vested in her, diminished by the debts chargeable to her, and the one-third interest in the residue of the community which she retained.

Only the decedent's one-half part of community property of a Texas resident is included in his gross estate for Federal estate tax purposes, because the ½ interest of the surviving spouse in the community property is a fully vested interest and not a mere expectancy. The interest of the first of the spouses to die is all that is included in his

estate. An excellent discussion of Texas community property system and its application in Federal Estate Tax matters, is contained in *Commissioner of Internal Revenue v. Chase Manhattan Bank, C. A. 5th Cir. 1958, 259 Fed. 2d 231, cert. denied 359 U. S. 913.* It is there said at page 239:

> "* * * Upon the death of either spouse, a community property state levies an inheritance tax on the decedent's half of the community. Since 1948 (and prior to 1942), only the decedent's half is includible in his gross estate for federal tax purposes."

In *Pitts v. Hamrick, C. A. 4th Cir. 1955, 228 Fed. 2d 486,* it is stated:

> "* * * where the widow's interest in the estate is allowed as a marital deduction, we look to the law of the state for the purpose of determining the amount of that interest."

It is clear that by electing to take under the will the one-half community interest of the wife is not included in the gross estate of the husband for tax purposes even though the wife's one-half community share, as well as the husband's one-half community share, was disposed of by the will of the husband. This is true because under Sec. 811(a) of the Revenue Code, the gross estate of the decedent includes only the interest of the decedent at the time of his death. Mertin's Law of Federal Gift and Estate Taxation, Sec. 11.02, Vol. 1, p. 687.

Any question in this regard is removed by GCM7773, CB IX-2, Page 426, Ruling 33-4750, which refers to Section 302(a) of the Revenue Act of 1926, which is virtually

identical, if not exactly identical, to the provisions of the Revenue Act in force at the time of the death of the decedent. (See Section 302(a) of 1926 Act and Section 811(a) of the 1939 Internal Revenue Code.) The GCM was based upon two cases in the Northern District of Texas, namely *Vincent v. United States* and *Underwood v. Reed.* The ruling is stated briefly as follows:

> "The husband, a resident of Texas, died leaving a will by which he devised to his wife and two children his entire separate estate, together with the entire community estate owned by himself and wife. The wife elected to take under the will.
>
> "HELD, that the interest which the wife has, under the laws of Texas in the community estate is not a part of the deceased husband's gross estate within the meaning of Section 302(a), Revenue Act of 1926, notwithstanding the wife elected to take under the will."

See also: *Coffman-Dodson Bank & Trust Co., Executor, 20 B. T. A. 890,* and *The Pacific National Bank of Seattle, Executor, 40 Board of Tax Appeals 128,* where the headnote states the ruling as follows:

> "(1) Where the wife of a decedent in a community property state (Washington) waives all her interest in the marital community and acquiesces in the creation by her husband of a testamentary trust disposing of all his property (with unimportant exceptions), including all community property, HELD, that there is no present transfer to the husband by reason of the waiver which will justify the inclusion of the wife's share of the community property in the decedent's gross estate."

Since the only property that passed to Mrs. Stapf from Mr. Stapf, under the will of the decedent, was the one-third

interest in the separate property and the one-half interest in the automobile, and since no part of Mrs. Stapf's community property is included in Mr. Stapf's estate, the respondent taxpayers do not contend that any part of the community estate owned by Mrs. Stapf qualifies for the marital deduction but assert, as determined by both the District Court and the Court of Appeals, that the interest in the separate property and one-half interest in the family automobile passing to the wife fully qualify for the marital deduction.

It is submitted that the circumstances under which such property so passed to Mrs. Stapf meets and satisfies all of the requirements of Section 812(e) of the Code. The one-third interest in the separate property and the one-half interest in the community automobile were included in the gross estate of the decedent as required by Section 812(e)(1)(A); the full and complete interest and title and not merely a terminable interest in the separate property vested in Mrs. Stapf as required under Section 812(e)(1)(B). The Government does not claim that the property passing to Mrs. Stapf was an interest in unidentified assets under Section 812(e)(1)(C) nor that the interest of Mrs. Stapf was conditioned upon her survival for a limited period under Section 812(e)(1)(D); nor is any claim made that the assets passing to Mrs. Stapf would not qualify as a marital deduction under Sections 812(e)(1)(F), (G) or (H); nor is any claim made that such property passing to Mrs. Stapf is disqualified under Section 812(e)(2).

The only issue raised by the Government as to the deductibility of the agreed value of the one-third interest in the

separate property and the one-half interest in the automobile passing to Mrs. Stapf is under Section 812(e)(1)(E) and particularly subsection (ii) thereof.

Section 812(e)(1)(E) reads as follows:

> "(E) Valuation of interest passing to surviving spouse. In determining for the purposes of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—
>
> "(i) there shall be taken into account the effect which a tax imposed by this chapter, or any estate, succession, legacy, or inheritance tax, has upon the net value to the surviving spouse of such interest; and
>
> "(ii) where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such incumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined."

Reduced to its simplest form, the basic contention of the Government is that since Mrs. Stapf exercised, after the death of her husband, the option granted to her in the will of electing to take under the will, the actual and agreed value of the property she received under the will should be assumed to have a zero or negative value in computing the marital deduction, thereby denying such deduction and increasing the estate tax liability in Mr. Stapf's estate as a result of "netting" what Mrs. Stapf received under the will and what she gave up by way of gift to the trustees. Obviously, the motivating force behind the Government's conten-

tion is its fear that in computing *gift taxes* on *Mrs.* Stapf's *gift*, made of her free choice after her husband's death, to the trustees for her children, the amount of her gift to the children may be reduced by the amount she previously received under her husband's will. Thus, the Government would deny the marital deduction in Mr. Stapf's estate thereby increasing the decedent's estate taxes in order to offset the possible loss of gift taxes owing by Mrs. Stapf.

The Government seeks to attain its basic objective of denying the marital deduction in this case by various arguments that circumvent the clear statutory language of Section 812(e)(1)(E)(ii) as well as the intent of Congress as clearly expressed and set forth in SENATE REPORT 1013, March 16, 1948, U. S. Code Cong. Service, Part 2, 80th Congress 2d Session, pp. 1163, 1188-1191, and SUPPLEMENTARY SENATE REPORT No. 1013, March 17, 1948, U. S. Code Cong. Service, Part 2, 80th Congress 2d Session, pp. 1222, 1224-1252.

The basic fallacy in the Government's position is that it seeks to fix the estate tax liability of the decedent's estate and the amount of taxable property includable therein for estate tax purposes on the basis of what it asserts to be the gift tax liability of Mrs. Stapf for gift taxes arising as a result of her gift to the trustees for the benefit of her children. The Government seeks to substitute the net benefit to Mrs. Stapf, used in determining her gift tax liability for her gift, for the value and amount of property passing to her and permitted to be deducted under Section 812(e)(1)(E) in determining the taxable estate of Mr. Stapf for estate tax purposes and the amount of estate taxes payable by Mr.

Stapf's estate. Mrs. Stapf's gift tax liability has no bearing upon the value *vel non* of the property included in Mr. Stapf's estate and passing to her.

In support of the position asserted by it, the Government relies upon Commissioner's Regulation 105, Section 81.47c (b), examples 1 and 3. Both the District Court (R. 28, 44) and the Court of Appeals (R. 64, 72) held that such regulation was an extension beyond the statutory language and the clear intent and purpose of Congress and that such regulation must give way to the statute, which permits the deduction of the value of the property passing to Mrs. Stapf in determining the taxable estate. Regulations of such character, as are the regulations here involved, as determined by both the District Court and the Court of Appeals, are invalid. *Commissioner v. Acker, 361 U. S. 87, 92; United States v. Calamaro, 354 U. S. 351, 358-359; Koshland v. Helvering, 298 U. S. 441, 446-447.*

Section 812(e)(1)(E)(ii) requires an "incumbrance or obligation" to be taken into account in valuing the property. Since the property that passed to Mrs. Stapf was not incumbered with a mortgage or like indebtedness, we must determine the meaning of "obligation" as used in the statute. SENATE REPORT 1013, March 18, 1948, U. S. Code Cong. Service, Part 2, 2d Session, pp. 1163, 1227-28. It is there explained:

> "Subparagraph (E) of Section 812(e)(1) specifically provides for the application in determining the value of any interest in property passing to the surviving spouse of rules which are generally applicable in determining the net value of any gift or bequest. * * *.
>
> "Clause (ii) of such subparagraph (E) directs that in determining the value of any interest passing from

> the decedent to the surviving spouse, incumbrances or obligations shall be taken into account in the same manner as if the value of a gift to the spouse of the interest passing were being determined. This is a clarification which was not expressed in the bill as passed by the House. If the decedent by his will leaves to his surviving spouse real estate subject to a mortgage (whether or not such mortgage was a personal liability of the decedent) the value of the interest passing to the surviving spouse does not under this section include the mortgage. If, however, the decedent by his will directs the executor to pay off the mortgage, such payment constitutes an additional interest passing to the surviving spouse. If the decedent bequeaths certain property to his surviving spouse subject, however, to her agreement, or a charge on the property, for payment of $1,000 to X, the value of the bequest (and, accordingly, the value of the interest passing to the surviving spouse) is the value, reduced by $1,000, of such property."

The "incumbrance or obligation" referred to in Section 812(e)(1)(E)(ii) was considered by the Court of Claims in *Wachovia Bank and Trust Company v. U. S., Ct. Cl. 1958, 163 Fed. Sup. 832*, and in *Estate of D. W. Byrd Gwinn, 25 T.C. 31*. In such cases it was concluded that "incumbrance or obligation" referred to in the statute was an incumbrance upon the property, or obligation or indebtedness of the decedent that became a charge upon the property. Like effect was given such statutory language in *Ballantine, Exr. v. Tomlinson, C. A. 5th 1961, 293 Fed. 2d 311*. It is clear from the language of the Senate Report, supra, that by use of the words "incumbrances or obligations" in the statute Congress had in mind an indebtedness or charge against the estate of the decedent or on the property passing thereby.

The Government would segregate the last sentence in the quotation from such report, and the illustration there given, and would take the position that such illustration is a comparable illustration to the fact situation here involved. It is submitted, however, that such sentence, either standing alone or in conjunction with the remainder of the paragraph, cannot support this construction. The parenthetical expression in such sentence of "or a charge on the property" clearly refers and defines the word "agreement" immediately preceding such language. Additionally, the use of the word "payment" connotes some obligation or indebtedness of the decedent which would constitute a charge upon the property passing to the surviving spouse. To read the sentence as the Government reads it is to read it out of context.

Clearly the language of the Senate Report as well as the statute, refers to a payment to be made out of property passing to the surviving spouse under the will or a charge upon the particular property and as pointed out in the District Court opinion (R. 28, 43) recognizes "certain contingencies which would be relevant to the value of the property identified with the marital deduction."

If the surviving spouse had no property of her own and was required to make the payment referred to in the last sentence of the quoted portion of the report to a third party, then such payment must be made out of the property received by the surviving spouse under the will. This clearly would be a charge upon the property and is obviously the type of obligation or charge on the property to which the Senate Report refers.

The "incumbrance or obligation" referred to in Section 812(e)(1)(E)(ii) is in effect defined by the statute itself when it is required that such incumbrance or obligation be "taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined." In *Wachovia Bank and Trust Company v. United States, Ct. Cl. 1958, 163 Fed. Sup. 832*, the Court of Claims states at page 836:

> "Within certain limitations which are not here relevant, an estate is entitled to deduct the actual value of property which has passed from the decedent to the surviving spouse. We think this is the plain intention of Sec. 812(e)(1)(E)(ii) which refers to the gift tax standard for valuation of incumbered property. The rule there stated is a simple one: if the property received by the surviving spouse is incumbered by an obligation which has not been discharged, then, obviously, its value to the recipient is only the equity and the marital deduction is correspondingly reduced. But if the decedent's estate is obligated to discharge the incumbrance, and there are sufficient assets so that the incumbrance is actually discharged, the value of the property to the recipient is the full market value and there is no corresponding reduction in the amount of the marital deduction. Estate of Gwinn, 1955, 25 T.C. 31."

The amount of a gift from H (husband) to W (his wife) on the condition that W give a part of her property to C (children) would not be reduced in determining the amount of gift taxes attaching to H's gift to W by the amount W gave to C. The gifts are not "netted" under such circumstances in determining the liability of H as donor for gift taxes. H's gift to W is reduced only by a consideration in

money or moneys worth passing from W to H, and not by a consideration passing from W to C. *Commissioner of Internal Revenue v. Wemyss, 324 U. S. 303; Merrill v. FAHS, 324 U. S. 308.*

The Government does not claim that any consideration in money or money's worth passed to Mr. Stapf, but merely that Mrs. Stapf suffered a detriment. Such a consideration, even if it might be considered a consideration at common law, is not such a character of consideration as would reduce the value of the property passing to Mrs. Stapf if the property is to be valued "as if the amount of a gift to such spouse of such interest were being determined" as required by Section 812(e)(1)(E)(ii).

The Government's contention is directly contrary to the holding in *Commissioner of Internal Revenue v. Wemyss, 324 U. S. 303.* In such case this Court had before it a situation in which the taxpayer had transferred to a Mrs. More a block of shares of stock pursuant to an agreement between himself and Mrs. More whereby she agreed to marry him. The former husband of Mrs. More had set up a trust which was to pay income to Mrs. More until she remarried and the transfer of stock to her was to compensate her for the loss of the income she would suffer on her remarriage. Just as the Government contends here, that the value of the separate property passing to Mrs. Stapf under Mr. Stapf's will should be reduced by the value of the community property relinquished by Mrs. Stapf, the taxpayer in *Wemyss* contended that the value of stock transferred to Mrs. More should be diminished by the value of the trust income that Mrs. More

relinquished. This Court in holding that the donor made a taxable gift to Mrs. More of the full value of the stock transferred to her, stated:

> "If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct. See Commissioner of Internal Revenue v. Bristol (CAA 1st) 121 F(2d) 129. To be sure, the Revenue Act of 1932 does not spell out a requirement of benefit to the transferor to afford relief from the gift tax. Its forerunner, Sec. 320 of the (June 2) 1924 Act, 43 Stat 253, 314, c 234, 26 USCA Int Rev Acts 1940 ed p 81, was more explicit in that it provided that the excess of the transfer over 'the consideration received shall * * * be deemed a gift.' It will hardly be suggested, however, that in re-imposing the gift tax in 1932 Congress meant to exclude transfers that would have been taxed under the 1924 Act. *The Section taxing as gifts transfers that are not made for 'adequate and full (money) consideration' aims to reach those transfers which are withdrawn from the donor's estate. To allow detriment to the donee to satisfy the requirement of 'adequate and full consideration' would violate the purpose of the statute and open wide the door for evasion of the gift tax.*" (Emphasis supplied.)

In *Estate of Koert Bartman, 10 T. C. 1073*, it was pointed out that the gift tax is an excise tax imposed, not upon the receipt of property by the donee, but upon the act of the donor of making the gift, and that the tax is measured by the value of the property passing. It was held there that where a husband gave his children certain property in consideration of their undertaking to pay an annuity to the donor and a contingent annuity to the donor's wife,

should she survive, that the value of the annuity to the donor should be deducted in valuing the property transferred, but no deduction should be made for the annuity undertaken by the donee for the benefit of the wife of the donor, who was a third party to the transaction. What the Government here insists should be done is in direct conflict with the decision of the Tax Court in such case. See also *Estate of John M. Goetchius, 17 T. C. 495; Commissioner of Internal Revenue v. Bristol, CCA 1st, 121 Fed. 2d 129; Lowndes and Kramer Federal Estate and Gift Taxes (2d Edition, 1962), p. 683, Sec. 32.2; Merten's Law of Federal Gift and Estate Taxation, Vol. 1, p. 287, Sec. 5.11.*

The Government in its brief seeks to avoid the holding of this Court in *Wemyss* by asserting that such decision has no bearing on the issue here because, so the Government says, such case does not specifically discuss and hold that the donor's gift was there made to a prospective bride rather than to her children. This argument merely begs the question because it is clear from the opinion that this Court considered and treated Mrs. More as the donee. The attempted distinction between *Wemyss* and the present fact situation is unwarranted because in *Wemyss* the Court had for determination the value, for gift tax purposes, of a gift from first party to second party, on what the Government would here characterize as a condition that second party would as a result of her action (marriage) give a part of second party's property to third party. This is the type of situation that the Government contends exists here, namely, by the widow's action (election) she gives a portion of her

property to third parties. The Government's attempted distinction is groundless. Here as in *Wemyss* there was no exchange of property between Mr. Stapf and Mrs. Stapf. Mr. Stapf received no consideration in money or money's worth, hence the value of the property he surrendered is not to be reduced under Section 812(e)(1)(E)(ii) because it is there required to be valued as if he were making a gift to Mrs. Stapf and the amount of such gift were being determined for gift tax purposes.

In putting emphasis on the word "any" and "in any manner" in Section 812(e)(1)(E)(ii) the Government distorts the purpose of the whole marital deduction provision and, as has been shown above, ignores the latter part of the statute that lays down the rule that the property to be excluded is to be valued as if the amount of a gift were being determined.

In *Estate of D. Byrd Gwinn, 25 T. C. 31*, the Tax Court had occasion to examine the section of the statute now under consideration. The decedent Gwinn was indebted to a bank and to secure the debt an insurance policy in which the decedent's wife was the beneficiary was pledged. The debts were paid by the decedent's administrator out of other assets of the estate. The question was whether the insurance proceeds qualified for the marital deduction or whether such policy was to be treated as being incumbered and applied to the payment of the decedent's debt to the bank thereby reducing its value, for marital deduction purposes, by the amount of the incumbrance. The Commissioner contended that the phrase "in any manner", referring to

the incumbrance, excluded, without exception, all property that was incumbered and that, therefore, the policy had a zero value for marital deduction purposes. The Tax Court rejected the contention of the government, and held that the object of the search was the value of the policy and, if the policy were to be valued as if it were a gift, that its value could not be diminished by the fact that it was pledged to secure the decedent's debt, where this debt was satisfied out of other property of the estate.

The Tax Court made a distinction between the situation, where there were not sufficient assets in the estate and the insurance proceeds had to be used to pay the debt, and where it was not necessary to use the proceeds for such purpose. A similar distinction is made by way of example in the portion of SENATE REPORT 1013 above quoted. The same distinction is applicable here. If Mrs. Stapf had been required to satisfy an incumbrance or obligation *out of the property* that passed to her from Mr. Stapf, then the value of the property passing to her would be reduced correspondingly. As we have seen, this was not the case, because the condition on which the property passed to Mrs. Stapf was that she make a gift *out of other property* that was hers, and over which the decedent had no control. Mrs. Stapf did not satisfy any debt or obligation of the decedent.

In its brief the Government advances an additional argument that wholly ignores and fails to comport with the factual situation here presented. It is contended by the Government that the last sentence in Section 812(e)(1)(E)(ii), in referring to the gift statute for the purpose of determin-

ing the *amount* of a gift, refers not to Section 1002 of the Revenue Code of 1939, relating to transfers for less than adequate and full consideration, nor to Section 1005 of the Revenue Code of 1939, relating to the valuation of gifts made in property, but refers to Section 1000(b) referring to the method of transfer and whether the gift is direct or indirect.

Under this argument the Government contends, in effect, that Mr. Stapf did *not* in fact make a testamentary gift of his separate property and interest in the automobile *to Mrs. Stapf*, but on the contrary that he made a gift to the trustees for the benefit of the children of a portion of Mrs. Stapf's one-half interest in the community property equal in value to one-third interest in his separate property and one-half interest in the automobile ($22,366.66). Such argument is fallacious because such method of reasoning ignores: the undisputed facts that $22,366.66 of Mr. Stapf's property passed to Mrs. Stapf under the will; the established law that Mrs. Stapf's ½ interest did not become become a part of Mr. Stapf's estate; the requirements of the very statute under consideration that the amount of the property passing to the surviving spouse is to be determined as if it were a gift; and the decision of this Court in *Wemyss* that such a gift is not to be reduced in value by the amount of a gift by the donee to a third party.

The title to the separate property and one-half interest in the community property automobile was unquestionably vested in the decedent, Mr. Stapf. The absolute title to the one-third interest in the separate property and the one-

half interest in the community automobile unquestionably passed to and vested in Mrs. Stapf absolutely without any interest being retained in the testator, as is required by Section 812(e) as explained by SENATE REPORT 1013, March 16, 1948, U. S. Code Cong. Service, Part 8, 80th Congress, 2d Session, p. 1163. The property that Mrs. Stapf surrendered and gave to the trustees for the benefit of her children was a part of her one-half interest in the community property and never became a part of Mr. Stapf's estate even upon her election to take under the will of her husband, GCM7773, CB IX-2, p. 426, Ruling 33-4750.

The position of the Government is that there were not two occurrences as the result of the exercise of the option by Mrs. Stapf after the death of her husband, namely, (1) the transfer of property from the decedent under his will to Mrs. Stapf that was subject to estate tax consequences, and (2) the gift by Mrs. Stapf to the trustees for the benefit of her children that was subject to gift taxes; but on the contrary, only one occurrence as a result of Mrs. Stapf's election, namely, a constructive or imagined transfer from Mr. Stapf to the trustees of a part of Mrs. Stapf's property. Such position of the Government is defeated by its reliance on the very cases on which it relies, namely, the decisions in *Commissioner v. Siegel, C. A. 9, 1957, 250 Fed. 2d 339;* and *Chase National Bank v. Commissioner, 25 T. C. 617, reversed on other grounds, C. A. 5, 259 Fed. 2d 231.* These cases involve the gift tax liability of surviving spouses for gifts made to third parties as a result of their

election to take under the will of their deceased spouse. These cases recognize, just as Mrs. Stapf recognizes here, that gift tax consequences attach to her gift of a portion of her fully vested property to the trustees for the benefit of her children. The other cases cited by the Government, *Vardell's Estate v. Commissioner, C. A. 5, 307 Fed. 2d 688,* and *Whiteley v. United States, W. D. Wash. 1963, 214 Fed. Supp. 489,* do not involve comparable situations. The last case *(Whiteley)* involved and agreement between the husband and wife during their lifetimes. The opinions in *Vardell* and in this case were by the same court, by the same judge and were certainly not considered to be in conflict.

This Court was not called upon to pass upon the decision in any of these cases, except on other points in *Chase National Bank,* either by appeal or petition for writ of certoriari. Unless distinguishable upon the facts, the decisions in *Siegel,* and the Tax Court decision in *Chase National Bank,* are in conflict with reasoning and the principles announced by this Court's decision in *Helvering v. Butterworth, 290 U. S. 365, 369-380.* Neither *Siegel* nor *Chase National Bank* involve estate taxes, or the liability for estate taxes, of the decedent's estate where the testator put the surviving spouse to the elections required in such cases. None of the cited cases involve the questiton of the marital deduction in the decedent testator's estate. Whether, under such circumstances, the decisions would have been the same is not known.

Perhaps, where a marital deduction has been allowed with respect to property passing to the wife as a result of

her election to take under the will, the full amount of a gift by her to third parties should be taxed in order to construe the gift tax statute in harmony with the estate tax statute. This problem as not been presented or passed upon in any reported decision and should properly await it presentation in a case involving the liabiliy for gift taxes in such circumstances. The problem is not presented in this case involving the estate tax liability of the decedent.

The Government contends that the gift tax liability of the surviving spouses, so determined in such cases, should fix and determine, in this case, the liability of Mr. Stapf's estate for estate taxes by netting the amounts surrendered by Mrs. Stapf against the amounts received by her. The Government contends that if this is not done the amount of the gift that Mrs. Stapf gave to her children escapes gift taxes to the extent of the value of property received by her. Even if this be true and the decision in *Siegel*, *Whitely* and the Tax Court decision in *Chase National Bank* correctly state the gift tax law applicable to *Mrs.* Stapf's gift to the trust, this does not authorize, as was determined by both the District Court and the Court of Appeals herein, the imposition of an estate tax in Mr. Stapf's estate without statutory authority.

Even though a portion of the value of Mrs. Stapf's property given to the trustees for the benefit of the children escapes gift taxes in an amount equal to the value of the property received by her under Mr. Stapf's will, certainly this does not authorize the levy of an estate tax on or the application of the estate tax rates to the property given by

Mrs. Sapf to her children. Such property so given to the children is, at the most, subject to gift taxes, but not estate taxes. Language authorizing the imposition of an estate tax on a gift, subject to gift tax, is not to be found in either the estate or gift tax statutes or the legislative history of either of such statutes.

If, by reason of the application of the gift tax statutes, a portion of the property given by Mrs. Stapf to her children will escape gift taxes, such problem is not here presented and this is a matter to be dealt with by Congress and not by the courts, as was pointed out by the Court of Appeals (R. 73-74). *The Hanover Bank, Executor v. Commissioner of Internal Revenue, 369 U. S. 672; Fabreeka Products Co. v. Commissioner, CA 1st, 294 Fed. 2d 876, 879; Commissioner v. Acker, 361 U. S. 87, 93; Helvering v. Sabine Transportation Company, 318 U. S. 306; Helvering v. Powers, 293 U. S. 214.*

The property passing to Mrs. Stapf from the decedent and qualifying for the marital deduction will not escape estate taxes because such property will be taxed in her estate upon her death in accordance with the intent of Congress in adopting marital deduction provisions.

In support of its contention that the deceased husband made a constructive gift (such term is used for lack of a better description) of his wife's property to the trustees for the benefit of their children, and that the value of the admitted testamentary gift to his wife should be netted against the property passing to the children so as to produce

a negative value for marital deduction purposes, the Government relies upon the provisions of Section 1000(b) of the Revenue Code, the regulations thereunder, and the decisions in *Helvering v. Hutchings, 312 U. S. 393*, and *Estate of Bartman v. Commissioner, 10 T. C. 1073, 1080*. None of the citations give credence to such position.

Helvering v. Hutchings, supra, involved the question of whether separate exemptions could be claimed for gift tax purposes for each of the beneficiaries of a trust where property had been given to one trustee for the benefit of several beneficiaries, or whether only a single exemption was permitted under the gift tax statute. The question there presented has no relation to the present problem and furnishes no guide here. No property was given to Mrs. Stapf in trust or otherwise for the benefit of their children. Whatever benefit the Stapf children receive comes from Mrs. Stapf as a result of the gift by her of her property and not from Mr. Stapf.

Estate of Bartman v. Commissioner, 10 T. C. 1073, cited by the Government likewise fails to give help to the Government's claims. We have previously pointed out that in such case the husband joined by his wife (who had only a dower or expectancy) made inter vivos gifts to their children in return for their agreement to furnish annuities to their father (donor) and their mother. It was held in line with the principles annuonced in *Commissioner v. Wemyss, 324 U. S. 303*, that the gift by the father should be reduced by the value of the annuity that he was to receive, but not by the value of the annuity passing to the mother, who, because she

had no vested interest in the property given to the children, was a third party since no money consideration was received by the donor (father) as a result of the annuity passing to the mother. This decision instead of supporting the Government's claims, support respondent taxpayer's position that the value of the property passing to Mrs. Stapf is to be valued "as if the amount of a gift to such spouse of such interest was being determined". Thus, the amount of the property so passing to Mrs. Stapf is to be reduced, as in the case of a gift, only by the money consideration passing to the testator and not by the amount passing from Mrs. Stapf to the children.

A third situation was presented in *Estate of Bartman*. The donor desired to give one of his sons (K. B., Jr.,) money and other of his children land, gave to three of his children (F., A. and R.) separate tracts of land and each of them, at donor's request, executed notes and delivered same to K. B., Jr., for $5000.00 each which were secured by mortgages on each of the separate tracts of land given to F., A., and R. The Court found with the petitioner that it was the intent and desire that these notes or obligations should be carved out of the total gifts. Such holding by the Tax Court is a clear example of what respondent taxpayers submit is the true meaning of Section 812(e)(1)(E)(ii) where reference is made to an "obligation" and SENATE REPORT 1013 explaining such section where reference is made to a "charge on the property". Such an "obligation" or "charge" on the property given to F., A., and R., reduced the value of the property passing to them. In an estate tax situation of the

nature here presented, the amount of their obligation, that was a "charge on the property" passing to them would be taken into consideration in valuing the property passing to them for the purpose of determining the amount of the marital deduction just as any other incumbrance or lien on the property so passing.

Section 1000(b) of the gift tax statute and the regulations thereunder, Regs. 108 (1939 Code) Section 86.2(a) Ex 2 and 3, relied upon by the Government likewise fail to give support to the Government in the fact situation presented by this case. Such portion of the statute and regulations thereunder relate to the question of whether a gift is made and do not relate to the valuation of the property passing. Section 1000(b), the Senate Report, Regulations 86.2, and the examples given therein, relate to different factual situations than here involved and are intended to cover and include for gift tax purposes inter vivos transactions of a different nature than here presented. As determined by the trial court and the Court of Appeals, it is the valuation sections of the gift tax statute to which reference is made in Section 812(e)(1)(E)(ii), and under such valuation sections the unincumbered property passing is to be reduced in value only if the consideration returning to the donor is in money or money's worth.

Contrary to the Government's assertion that the opinion of the District Court and the Court of Appeals thwarts the intent of Congress when it adopted the marital deduction provisions, the adoption of the Government's position would destroy what Congress intended and enacted. As pointed out

in SENATE REPORT 1013, March 16, 1948, U. S. Code Cong. Service, Part 2 80th Congress, 2d Session, pp. 1163, 1188, "The basic differences between property rights in community-property and non-community-property States have also resulted in geographic inequalities in the effect of the estate and gift taxes." As has often been said, the purpose of the adoption of the marital deduction provisions was to eliminate such geographic inequities recognized as unjust by Congress. It was recognized in the Senate Report last referred to on p. 1189, as follows:

> "With the repeal of the 1942 amendments your committee recommends estate and gift tax splitting which is similar in its effects to the splitting of the income tax provided for in this bill. It is recognized that complete equalization of the estate and gift taxes cannot be achieved because of the inherent differences between community property and non-community property. However, the new provisions will result in equality in the important situations."

Respondent taxpayers agree with the statement of the Government on p. 14 of its brief as follows:

> "The purpose of the marital deduction was to extend to taxpayers in common-law jurisdictions the advantages of estate 'splitting' previously enjoyed only by taxpayers in community-property jurisdictions—namely, the lower total tax resulting from the application of progressive estate-tax rates separately to two halves rather than to one whole."

The adoption of the theory asserted by the Government in denying the marital deduction in this case will bring back the situation that existed between 1942 and 1948, where the property passing to Mrs. Stapf would be taxed twice, once in Mr. Stapf's estate and again in Mrs. Stapf's estate.

The *Siegel* case and other cases cited by the Government, involving gift tax liability of the surviving spouse in respect to the valuation of property given by the surviving wife to third parties, were decided without respect to what had been the liability of the estate of the deceased husband for estate taxes. If, as the Government contends, the estate tax liability of Mr. Stapf's estate is to be controlled by the liability of Mrs. Stapf for gift taxes or by Example 3 the regulation of the Commissioner [Reg. 105, Sec. 81.47c(b)] which is directed at community property estates alone, then the same inequities sought to be eliminated by the Revenue Act of 1948 will again exist. This is true because in a community property state, where each of the spouses owns a ½ vested interest, the property passing from the husband to the wife and otherwise qualifying for the marital deduction would be taxed twice; whereas in a non-community property state under regulation 105 Sec. 81.47c(b)(3) (applying to a community property state) the marital deduction would presumably be allowed and such property would be taxed only once.

Actually, in a non-community property state the same incorrect result of taxing the same property twice for estate tax purposes will follow if the Government's theory is applied in a like situation (where the wife owns separately vested property) in such a state even though the example in the regulations applies by its terms only to community property states. In a non-community property state, where the husband has the power of testamentary disposition of the entire property accumulation of the marriage, subject to

the dower or similar rights of the wife, a situation comparable to the one here involved could not arise unless the wife owned in her own right a vested interest in property of her own. This is true because by the express terms of the statute a dower, or statutory interest in lieu thereof, is defined to "pass" from the deceased husband to the surviving spouse, and qualifies for the marital deduction. See *Sec. 812(e)(3)(C) of 1939 Code; United States v. Crosby, C.A. 5th, 257 Fed. 2d 515; United States v. Traders National Bank of Kansas City, C.A. 8th, 248 Fed. 2d 667; Dougherty Exr. v. United States, C.A. 6th, 292 Fed. 2d 331.*

A comparable situation, to the one here involved, could arise in a common law state where the husband has the power of testamentary disposition of the entire property acquired during coverture, but the wife additionally owns property in her own right. To illustrate, suppose in such a common law state, there is total property accumulated during coverture of $200,000.00, and the husband by his will gives ½ of such property of the value of $100,000.00 to his wife on the condition that she give a portion of her separately owned and fully vested property, valued at $150,000.00, to a trust created by the husband, in his will, with the remaining $100,000.00 of the joint property. The wife elects to take under the will and makes such a gift.

Since $100,000.00 passing to the wife qualifies for the marital deduction, same should be deducted from the husband's gross estate, leaving $100,000.00 subject to estate tax in his estate. On the death of the wife the $100,000.00 she received would be subject to estate taxes in her estate.

Thus, the $200,000.00 of property acquired during coverture would be taxed only once for estate tax purposes.

Under the Government's theory the $100,000.00 passing to the wife is taxed twice for estate tax purposes though only one tax is levied under the marital deduction provisions. By refusing the marital deduction, the total $200,000.00 estate would be valued and taxed at $200,000.00 in the husband's estate and the $100,000.00 passing to the wife would again be taxed in her estate on her death.

This is clearly contrary to the intent of Congress in the marital deduction statute, yet the special provisions of the regulations, applicable to community property states, produces this result if applied to the above exampled situation in a non-community property state.

If these regulations are only applicable to community property states, as they purport to be, and the Government's theory would not be applied in common law states by the Commissioner and Revenue Agents because of a lack of regulations, an even worse result would obtain because of lack of uniformity, and the residents of non-community property states would be treated differently than residents of community property states contrary to the express purpose for the adoption of the marital deduction provisions.

The fear of the Government that "startling" tax evasion results can be obtained in non-community property states as a result of the decisions of the District Court and Court of Appeals herein is without foundation.

Neither the statute nor the decisions below authorize a marital deduction in a situation where the widow owns no vested property of her own, in either a community property or non-community property state as envisioned in footnotes 14 and 15 on pages 15 and 16 of petitioner's brief and as suggested in the argument of the Government on such pages of its brief. The hypothetical or exampled situations there listed, and particularly the one noted on page 16 (footnote 15), where the husband's will gave to the wife (who owned no property) $100,000.00 on the condition that she give $100,000.00 of General Motors Stock to her son, evidence a misconception by the Government of the position of the respondents and the effect of the decisions below.

The Government argues that a marital deduction could be obtained in such a hypothetical situation and both estate and gift tax avoided by the widow using the testamentary gift of $100,000.00 to her to buy the required stock to give to her son. Such is not the case, because the requirement or obligation that the widow acquire and give the General Motors stock to her son is clearly "a charge upon the property" (as used in SENATE REPORT 1013) passing to her since her obligation *could only be satisfied out of the property passing to her.* In valuing the property passing to the widow under such circumstances, Sec. 812(e)(1)(E)(ii) would require the "obligation" or "charge on the property", to acquire the $100,000.00 of General Motors stock out of the property passing to the widow, to be deducted from the $100,000.00 bequest in valuing the property passing to her and thus determining the amount of permissible marital

deduction because the obligation, incumbrance, or charge on the property could only attach to the property so passing. Respondents do not contend otherwise. The opinions below do not hold otherwise. The Government, in such a situation, could ill afford to claim otherwise.

The hypothetical case in footnote 15 of the Government's brief is a similar or parallel illustration to the illustration in SENATE REPORT 1013 as reported on page 1228, U. S. Code Cong. Service, part 2, 80th Congress 2d Session, where it is stated:

> "If the decedent bequeath certain property to his surviving spouse subject, however, to her agreement or a charge on the property, for the payment of $1,000 to X, the value of the bequest (and, accordingly, the value of the interest passing to the surviving spouse) is the value, reduced by $1,000, of such property."

This is obviously the same situation illustrated in Example No. 1 of Regulation 105, Sec. 81.47c(b).

The Government's hypothetical situation and the examples in the Senate Report and the regulation are entirely different from the situation here presented. Mrs. Stapf was given the option of taking her part of the community property passing under the will to her or taking her one-half of the net community property. She exercised her option to take under the will after the death of her husband as a matter of free choice. She received the property passing to her under the will and gave a part of her property, never included in the estate of her husband, to the trustees for the benefit of her children and her gift is subject to such gift tax consequences as may be imposed by the gift tax

statute. If the marital deduction is denied by netting, for estate tax purposes, what she gave and what she received, and the value of the property passing to her is thereby reduced to zero, as Government contends should be done, an estate tax, at estate tax rates but not gift tax rates, is effectively levied on a part of Mrs. Stapf's property given by her to her children and subject to gift tax, but not estate tax. Respondents submit such a levy is unauthorized under any statute.

II

Because the law of Texas authorizes and allows payment of all community debts out of decedent's one-half of the community estate under a will provision expressly directing such payment, decedent's estate is entitled to a deduction for estate tax purposes of the entire amount of such community debts.

The basic reason that decedent's estate is entitled to a deduction of the full amount of community debts as claims against the estate is that, if effect is to be given to the direction in decedent's will for the payment of all such debts from his one-half of the community as the State law requires, the entire amount of such community debts meet and satisfy the criteria set up by the applicable code provision, Sec. 812(b), for deduction of "claims against the estate".

In determining the deficiency, the Commissioner allowed as a deduction in the decedent's estate only one-half

($16,183.87) of the total claims. The action of the Commissioner was approved by the District Court but reversed by the Court of Appeals with Judge Wisdom dissenting.

Section 812 of the Internal Revenue Code of 1939, as amended, being the applicable statute, provides in part:

"Section 812 Net Estate

"For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

"(a) Exemptions. An exemption of $100,000;

"(b) Expenses, losses, indebtedness, and taxes. Such amounts—

"(1) for funeral expenses,

"(2) for administration expenses,

"(3) for claims against the estate,

"(4) * * *

"*as are allowed by the laws of the jurisdiction*, whether within or without the United States, *under which the estate is being administered*, * * *." (Emphasis supplied.)

This section is the same as Section 303 of the Revenue Act of 1926 with respect to which it was said by the Circuit Court of Appeals, Third Circuit, in *First-Mechanics Nat. Bank of Trenton, et al. v. Commissioner of Internal Revenue, 117 Fed. 2d 127:*

"Unquestionably, a claim against a decedent's estate which is allowed by the laws of the jurisdiction under which the estate is administered is deductible in deter-

> mining the net estate subject to federal tax. The Revenue Act applicable to the instant case specifically so provides."

See also *Lang's Estate v. Commissioner of Internal Revenue, by Circuit Court of Appeals, 9th Circuit, 97 Fed. 2d 867; Thompson v. Wiseman, CCA 10th Cir., 233 Fed. 2d 734.*

Uniformity in the application of the statute with respect to deductions was not expected by Congress as pointed out by the U. S. Court of Appeals for the Third Circuit in *Commissioner v. Cardeza's Estate, 173 Fed. 2d 19, at 23:*

> "The question of deductibility of the $25,000 trust for mausoleum manintenance need not long detain us. As the Tax Court pointed out, the statute allows a deduction for 'such amounts * * * for funeral expenses * * * as are allowed by the law of the jurisdiction under which the estate is being administered.' *Here, then is an instance where Congress, rather than attempting uniformity, specifically has contemplated that local low determine the quantum of the deduction.* We need not gloss over the already clear picture of Pennsylvania's attitude toward funeral expenses which is set forth in the Tax Court opinion." (Emphasis supplied.)

In practice, uniformity in treatment of deductions by the estate is certainly not achieved. Perhaps the lack of uniformity can best be illustrated by a reference to a few of the community property states. Thus, funeral expenses are deducted in their entirety from the ½ community property interest of the decedent if the estate is administered in Texas *(Blair v. Stewart, 49 Fed. 2d 257, 5th Cir., cert. denied; 284 U. S. 658)*, or in Idaho *(Estate of W. S. Lee v. Commissioner, 11 T. C. 141)*, while only ½ of the funeral

expenses are deducted if the estate is administered in the State of Washington *(Lang's Estate v. Commissioner, 97 Fed. 2d 867; The Pacific National Bank of Seattle, 40 B. T. A. 128.)*

In the absence of will provisions otherwise directing, only ½ of the administration expenses are deducted in Texas upon the theory that the whole of the community estate is being administered. *Estate of H. C. Schuhmacher, 8 T. C. 453.* The same is true in the State of Idaho, *Estate of W. S. Lee, 11 T. C. 141*, but the contrary is held in the State of Louisiana, *Vaccaro v. United States, 55 Fed. Supp. 932, affirmed CCA 5th, 1945, 149 Fed. 2d 1014; McCullough v. United States, 134 Fed. Supp. 673; Estate of Thomas E. Gannett, 24 T. C. 654; Estate of William G. Helis, 26 T. C. 143.*

Regardless of whether all of the administration expenses, and not merely a pro rata part thereof, and all of the community debts, and not merely ½ thereof, are to be deducted from the community ½ interest of the deceased spouse who might die intestate, or where there was no provision in the will with respect thereto, it is submitted that where the will specifically directs that *all* of the administration expenses and *all* of the debts, and not merely part thereof, be charged against and collected out of the decedent's ½ community interest, that then the provisions of the will must be carried out, and such debts and expenses must be charged against and deducted from the ½ share being administered in determining the liability for estate taxes.

The principle asserted by these respondent taxpayers was clearly recognized and set forth by the Board of Tax Appeals of the United States in *Estate of Eucy O. McGugan, Deceased, 47 B. T. A. 658*, in which the Commissioner of Internal Revenue acquiesced. The headnote of syllabi appearing in the official Board of Tax Appeals report clearly states in shortened form the holding of the Court as follows:

> "Funeral expenses and expenses of last illness of a married woman dying testate a resident of Florida, paid pursuant to the terms of the last will and allowed by the laws of the state as a charge against the gross estate, HELD a legal deduction from the gross estate."

The facts in the case were that the will of Mrs. McGugan provided:

> "I direct that all of my just debts and funeral expenses be paid out of my estate as soon after my decease as shall be found convenient."

The decedent was survived by her husband, Arthur McGugan. Under the laws of the State of Florida the surviving husband was primarily liable for the payment of the funeral expenses. The Court, however, gave effect to the provisions of the will and required that the funeral expenses be paid out of the estate of the decedent pursuant to the terms of the will and deducted from the gross estate in determining the net taxable estate. The Court in such regard said:

> "* * * It has been held that, even though under the common law these expenditures are regarded as primary liabilities of the surviving husband, the husband is relieved of such liability where the wife directs in her will that they be paid out of her estate and leaves sufficient property for their payment.

"It is clearly the purpose of the Federal estate tax law to permit the deduction of such items if allowed by the laws of the jurisdiction under which the estate is being administered. Since it is stipulated that the items in dispute were paid by the executor and that the administration of the estate has been closed, the items apparently were allowed as deductions from the gross estate by the laws of the State of Florida.

"We are of the opinion that the respondent erred in his disallowance of the deduction from the gross estate of the funeral expenses and expenses of decedent's last illness."

Estate of Lucy O. McGugan, Deceased, supra, was followed by the Tax Court in *Estate of Mrs. Sarah H. Bradley, Docket No. 106452, Prentice-Hall 1943 T. C. Memorandum Decisions, 1195; CCH 2 TCM 609.* There the Tax Court had under consideration whether the funeral expenses of the decedent wife should be allowed as a deduction in computing estate taxes where, under the laws of Georgia, where the estate was being adminstered, the surviving husband is primarily liable for such funeral expenses. The will in such case provided that all just debts should be paid and a marble slab erected over the grave of the decedent. The Court held that, even though the surviving husband was primarily liable for funeral expenses and his wife's estate was secondarily liable for the payment thereof in the State of Georgia, full effect nevertheless must be given to the will, and the entire amount of the funeral expenses were allowed in determining the Federal estate tax upon the estate.

The principle that community debts are deductible in their entirety from the decedent's ½ community interest for

determining estate tax liability where directed by the provisions of the decedent's will was recognized by the 9th Circuit Court of Appeals in *Lang's Etate v. Commissioner, 97 Fed. 2d 867*, where it is stated at page 871:

> "On this issue we think the Board was correct in permitting a deduction of only one-half of these community obligations. Regardless of the incidents of the husband's personal liability for community debts during his lifetime, section 1342, Remington's Revised Statutes, supra, as construed by the Supreme Court of Washington, requires that community debts be satisfied pro rata from that portion of the community property distributable to the wife and that portion subject to the husband's testamentary disposition. *It is only by provision of a deceased husband's will that a community debt may be charged solely against his share of the community. Redelsheimer v. Zepin*, 105 Wash. 199, 202, 177 P. 736; in re *Hart's Estate*, 150 Wash. 482, 492, 273 P. 735." (Emphasis supplied.)

The right of a testator to charge community debts and administration expenses against his ½ part or share of the community estate where same would not otherwise be chargeable in its entirety, is recognized: in the State of Washington, *Lang's Estate v. Commissioner of Internal Revenue, supra; Redelsheimer v. Zepin, 105 Wash. 199, 202, 177 Pac. 736; In Re: Hart's Estate, 150 Wash. 482, 492, 273 P. 735;* and in the State of California, where it was stated in *In Re Marinos' Estate, 102 P. 2d 443:*

> "The law is clear that in the absence of an expression of a contrary intent, the entire community property, including the interest of the surviving widow, is subject to the debts and expenses of administration upon the death of the husband. * * * The converse is also true—

that is, if the will designates that debts should be paid from the interest of the husband, the wife's share of the community property is exonerated, if the husband's share is sufficient to pay all such debts and expenses. * * *"

The rule so clearly stated in the case last cited is the rule in Texas. Debts and administration expenses, though chargeable against the entire community estate in the absence of specific provisions to the contrary, are chargeable in their entirety against the deceased husband's one-half where the will so directs. This rule of law is made clear by the Court of Civil Appeals for the Seventh Supreme Judicial District at Amarillo in the case of *Medlin v. Medlin, 203 S. W. 2d 635*, and by the Supreme Court of Texas when a writ of error was refused in such case.

Thus, it appears that the point here urged has been squarely placed before the Supreme Court of Texas, and it has squarely ruled that the testator may, by his will, relieve his wife's share of the community estate of liability for the payment of community debts to the extent that testator's share is sufficient to discharge such debts and expenses, even in a case where the debts exceeded the one-half community interest of the deceased.

Other Texas cases recognize the right of a testator to direct that debts and expenses be paid out of certain portions of his estate, and that the determination of whether debts, expenses, or administration and attorneys' fees should be borne by the community estate depends upon the intent of testator as expressed in his will. We refer to *Thompson v. Thompson*,

236 S. W. 2d 779, 149 Tex. 632, and *Matthews v. Jones, 245 S. W. 2d 974, writ refused.* In the case last cited the decedent had written a will and various codicils. The suit involved the question of who should be charged with the debts and expenses under the will and codicils. It is stated at page 977:

> "Judgment was entered in the District Court exonerating one-half of the separate property left in trust for the widow from payment of expenses of last illness and funeral, indebtedness of decedent for benefit of separate property, one-half of community indebtedness, expenses of administration of entire separate property and one-half of the community estate, the federal estate tax, all inheritance taxes, and charging the one-half of the community estate and one-half of the separate property left in trust for the children with the payment thereof.
>
> "• • •
>
> "It urged by appellants that the will of Percy Jones 'made no provision, ambiguous or otherwise, as to apportionment of the burden of debts, expenses of administration or taxes among the beneficiaries' and that 'the court should have placed the burden, as a matter of law, and not of construction;' that, as a matter of law, the property devised in trust for the widow should be charged with a pro rata share of such items. The determination of the question here presented hinges upon the intention of the testator as expressed in the will, as evidenced by its terms when considered as a whole if his intent can be determined therefrom."

There can be no question with respect to the intent of the testator, Lowell H. Stapf, to charge all, and not merely ½ of the debts to his ½ share and part of the community estate until its exhaustion, and next to the separate estate. It is

equally clear that the same was true with respect to administration expenses, including attorneys' fees incurred in connection with the administration of the estate.

Under the cases above cited, it cannot be questioned that the testatof, Lowell H. Stapf, was fully authorized and empowered to charge his share and portion of the community estate with all of the community debts and all of the costs of administration and to exonerate the ½ share of Mrs. Stapf in the community property from such debts and expenses. It cannot be questioned that Mr. Stapf did in his will everything possible to charge his ½ of the community estate with such debts and taxes. Since Mr. Stapf was permitted by the laws of the State of Texas to do just what he did by his will; then such debts and expenses are deductibe in their entirety in determining the amount of net estate taxable for estate tax purposes because the state law determines what debts and expenses are to be deducted from the share and part of the estate being taxed, subject, however, to the limitation stated by the Court of Appeals in the opinion below, that only ½ of the debts founded on a promise or agreement are deductible.

The Government does not claim that the provision in the will directing payment of all debts and expenses out of decedent's one-half of the community property is invalid or ineffective under Texas law. The Government asserts that these Texas decisions are not controlling because they do not concern the deduction of the claims for estate tax purposes. The opinion of the Court of Appeals appropriately disposes of this contention with its observation that, "It is true that

neither of these cases involved taxes, but the regulation here requires only that the payment be authorized under the Texas law. Cf. *In re Marinos' Estate, Cal. Dist. Ct. App. 1940, 102 P. 2d 443.*" (R. 64, 69.) It cannot be expected that state law will speak in the area of estate tax deductions, as such, and the code clearly calls upon the state probate law to determine what claims qualify under Sec. 812(b). The last quoted part of the Court of Appeals' opinion is equally applicable to petitioner's assertion, without citation of authority, (page 20 of brief) that state law governing the enforceability of such a will provision concerns the validity of wills and does not concern the allowance of claims and is thus irrelevant. However, if such a will direction is enforceable under state law, which petitioner admits is the case in Texas, then the claimant may collect in full from decedent's estate and the estate will bear the full burden of such payment, regardless of whether this is so under the law governing validity of wills or under the law governing the allowance of claims.

The only impediment to full deduction of community debts by the estate of a deceased husband in the absence of a direction to pay such debts in full in the will, is that under "the laws of the jurisdiction" only one-half of such claims are ultimately chargeable to the decedent's estate. But that impediment does not exist in this case because the will provision makes the decedent's estate wholly responsible for the community debts. The "laws of the jurisdiction" permit a decedent to remove the impediment by such a will provision and the Government's position in this question is

necessarily in derogation of the "laws of the jurisdiction." The cases cited in petitioner's brief are not to the contrary since none of these cases involve a will situation where the testator assumed the debts and gave up any right of reimbursement from his wife's part of the community.

The Government does not quarrel with the fact that the entire amount of community debts "represent personal obligations of the decedent existing at the time of his death", as is required by Treasury Regulation 105, Section 81.36. The law of Texas is that the husband, and his estate after his death, is personally liable for community debts, whereas the wife is not. *Davis v. McCarney, 64 Tex 584; Leatherwood v. Arnold, 66 Tex. 144, 1 S. W. 173; Anderson v. Bundick, 245 S. W. 2d 318 (Tex. Civ. App., err. ref. n.r.e.)*. The fact is that the husband is the only one who is personally liable, and if a personal judgment could not be obtained against him for the full amount of community debts, it could be obtained against no one.

The Government does not deny that the decedent, while alive, was personally liable for the full amount of the community debts. Decedent's estate cannot escape such liability and if the estate pays only one-half of such claims the owners of the claims are fully entitled to obtain a judgment against the estate and collect the other one-half of their claims in satisfaction of such judgment, out of estate assets, even though the estate will have a right of reimbursement from the wife's community interest of one-half of the total claims where there is no direction in the will for payment of the entire debt out of decedent's estate.

This being true, how can it logically be argued that the claimants have a valid cause of action against the estate for the full amount of community debts, yet they have no "claim against the estate" except as to one-half of such claim. The claimants are fully entitled to file a "claim" with the executor of the estate for the full amount of the debt owed them by the community and are entitled to have such "claim" satisfied in full by the decedent's estate—such a claim is exactly what is encompassed by the Code provision allowing deduction of such "claims against the estate * * * as are allowed by the laws of" the jurisdiction where the estate is being administered.

While the Court of Appeals did not reach, and did not have to reach, the question of full and adequate consideration, the Government injects such issue into the case without warrant. The requirement of Sec. 812(b) that the deduction for claims be limited to those contracted for "an adequate and full consideration in money or money's worth" is applicable (by the very terms of the statute) to those founded upon "a promise of agreement". As pointed out by the Court of Appeals (R. 70), the debts here involved "were in the main income taxes and ad valorem taxes." These are debts imposed by law and not debts founded upon "a promise or agreement" with respect to which the consideration requirement is applicable. At no point has the Government attempted to segregate contractual claims or contended that any of the claims should be treated differently from the claims for taxes.

Petitioner asks us to look at "the transaction by which the decedent's estate became liable to pay the entire debts of the community without recourse to the wife's half" presumably referring to the will provision. Brief for the United States, p. 21. But regardless of what decedent's will provided, the United States, as a holder of income tax claims, the ad valorem taxing authorities, and the other claimants involved, each had a legal claim and cause of action against the estate for the *full* amount of his claim, not just the half chargeable ultimately to decedent's estate had there been no direction for payment of the will. These claims were not "created" by the decedent's will but rather by the taxing laws and the other underlying transactions; they were effective claims imposing personal liability on decedent without regard to his will. They were claims imposed by law, not claims based upon contract. Therefore, the requirement of full and adequate consideration in money or money's worth does not enter the picture here.

The petitioner's position appears to be dictated by a fear of tax avoidance and discrimination which it visualizes as resulting from the majority opinion of the Court of Appeals upon this point. Such fears are unfounded under the majority opinion because the opinion recognizes (R. 70), that if the "claims", for which deductions are allowed, are founded on contract ½ of the consideration (such as the proceeds of a loan) would go into the ½ community estate of the surviving wife and that under such circumstances,

the contention of the Government that only ½ such a debt (one founded on a contract) would be deductible, would prevail.

Thus, the supposed example in the dissenting opinion (R. 74, 84), and a like example in the Government's Petition for Writ of Certiorari (pg. 14 of petition), but not carried forward in the Government's brief, whereby discrimination between states would result and taxes be avoided through a manipulation of liabilities and assets of the community estate by borrowing could not occur under the majority opinion of the Court of Appeals. The supposed results in such situations are contrary to the express holding of the majority opinion, because debts or claims, created through the borrowing of funds, are clearly based on contract or agreement and deduction would be obtained under the majority opinion for only one-half of such debts since there would be full and adequate consideration to the decedent's estate for only that portion.

The manager of the community could not manipulate claims imposed upon his estate by operation of law in such a manner as to avoid taxes or provide a windfall. Congress, by providing that the claims, which are deductible, are those which are permitted by the laws of the state where the administration is pending, but limiting those claims founded on contract to those supported by a full and adequate consideration, authorized the deduction of claims imposed by law where, under the local law, the testator is allowed to assume such debts under his will. This is permissible in Texas under

the majority opinion; in Florida under *Estate of Lucy McGugan, Deceased, 47 B.T.A. 658;* in Georgia under *Estate of Mrs. Sarah H. Bradley, T.C. Docket 106452, Prentice-Hall 1943 T. C. Memorandum Decision 1195; CCH 2TCM 609,* and presumably in California and Washington under *Lang's Estate v. Commissioner of Internal Revenue, CCA 9th 1938, 97 Fed. 2d 867, 871; In Re Marinos' Estate, 102 Pac. 2d 443; Redelsheimer v. Zepin, 105 Wash. 199, 202, 177 Pac. 736; In Re: Hart's Estate, 150 Wash. 482, 492, 273 Pac. 735.*

The fact that all states may not allow and enforce such a testamentary provision is of no consequence because uniformity is intrinsically impossible to achieve under a provision that calls for the state law of the various states to govern the deductibility of claims.

The Government's position seeks to impose an unnatural meaning on the word "claim" as used in the provisions of the Code permitting deductions, and to engraft thereon language not contained in the Code. This Court has required language in the revenue laws to be given their plain, literal meaning, *Hanover Bank Executor v. Commissioner, 369 U. S. 672,* and this Court has many times affirmed the sound and accepted maxim that "where there is a reasonable doubt as to the meaning of a taxing act it should be construed most favorably to the taxpayer". *White v. Aronson, 302 U. S. 16.* The following language from *Crooks v. Harrelson, 282 U. S. 55, at 59,* is appropo:

> "It is urged, however, that if the literal meaning of the statute be as indicated above, that meaning should be

> rejected as leading to absurd results, and the construction adopted in harmony with what is thought to be the spirit and purpose of the act in order to give effect to the intent of Congress. The principal sought to be applied is that followed by this Court in Church of the Holy Trinity v. United States, 143 U. S. 457, 36 L. Ed. 226, 12 S. Ct. 511; but a consideration of what is there said will disclose that the principal is to be applied to override the literal terms of a statute only under rare and exceptional circumstances. The illustrative cases cited in the opinion demonstrate that to justify as departure from the letter of the law upon the ground, the absurdity must be so gross as to shock the general morale or common sense."

As is stated above, the attempted demonstrations by Petitioner of far reaching tax avoidance under the decision by the Fifth Circuit is not justified, and there is no substantial reason why the terms of the Code provisions should not be given their literal, ordinary interpretation, so as to allow decedent's estate a full deduction for the community debts.

If for any reason the debts and claims, whether arising by operation of law or as a result of a contract or agreement, as well as administration expenses on the estate of the decedent are not entitled to be deducted in determining the estate tax liability under Sec. 812(b), under the will provisions, but are to be treated and considered as merely pecuniary bequests as the Government contends, then such debts and administration expenses, so assumed by the testator, qualify for the marital deduction to the extent that such claims and exepnses when added to the value of other property, qualifying for the marital deduction, does not exceed ½ of the "adjusted gross estate."

This fact is recognized by the Government on page 15 of their Petition for Writ of Certiorari filed herein. The Government, of course, contends that no marital deduction is available in this case for the reason that Mrs. Stapf gave up more than she got. For the reasons discussed in the preceding point in this brief and for the reasons assigned by the District Court and the Court of Appeals, this is not a valid basis for denying the marital deduction in this case by netting what the wife received under the will and what she voluntarily gave to the trustees for her children by the exercise of her option.

III

Because the law of Texas authorizes and allows payment of all administration expenses out of decedent's ½ of the community estate under a will provision expressly directing such payment, decedent's estate is entitled to a deduction for estate tax purposes of the entire amount of such administration expenses.

The Court of Appeals was correct in treating administration expenses and community debts together. The deduction in full of both administration expenses and community debts, where there is a will provision directing such expenses and debts paid in full out of decedent's property is supported by the same arguments. The requirement that the debts to be deducted be personal obligations of the decedent and that

contractual debts be for a full and adequate consideration have no application to the administration expense deduction.

The only question necessary to ask is whether the law of Texas allows decedents' estates to pay administration expenses in full, with no reimbursement from the wife's share of the community, where the decedent's will direct full payment of such expenses out of his portion of the estate, as is here provided. That Texas law allows the administration expenses to be paid in full out of the decedent's estate under such circumstances, is not contested by petitioner. Such fact is clear under the decisions of *Thompson v. Thompson, 149 Tex. 632, 236 S. W. 2d 779*, and *Mathews v. Jones, 245 S. W. 2d 974, writ of error refused.*

Without repeating the arguments under the preceding Point II with respect to community debts, the reasons advanced for the allowance in deduction of such debts in full are reasserted with respect to administration expenses. By the same token, if the administration expenses are not deductible in full in determining the decedent's estate tax liability such expenses qualify for the marital deduction as discussed under the preceding point.

CONCLUSION

For the reasons herein advanced, it is respectfully submitted that the judgment of the United States Court of Appeals for the 5th Circuit should be affirmed and that this cause be remanded to the District for such other and further

proceedings as may be necessary and which are not inconsistent with the opinion of this Court and the United States Court of Appeals for the 5th Circuit.

Respectfully submitted,

W. M. SUTTON,
H. A. BERRY,
JERRY F. LYONS,
WINSTON R. SMITH,
P. O. Box 550,
Amarillo, Texas,
Attorneys for Respondents.

Of Counsel:
UNDERWOOD, WILSON, SUTTON,
HEARE & BERRY
P. O. Box 550,
Amarillo, Texas.

APPENDIX A

INTERNAL REVENUE CODE OF 1939 (AS AMENDED, 26 U.S.C., 1952 ED.)

SEC. 812. NET ESTATE.

For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

* * * * *

(b) [as amended by Secs. 405(a), 406, Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 502, Revenue Act of 1950, c. 994, 64 Stat. 906]. *Expenses, Losses, Indebtedness, and Taxes.*—Such amounts—

(1) for funeral expenses,

(2) for administration expenses,

(3) for claims against the estate, and

(4) for unpaid mortgages upon, or any indebtedness in respect to, property where the value of decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,

as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered; but not including any income taxes upon income received after the death of the decedent, or property taxes not accrued before his death, or any estate, succession, legacy, or inheritance taxes. The deduction herein allowed in the case of claims against the estate, unpaid

mortgages, or any indebtedness shall, when founded upon a promise or agreement, be limited to the extent that they were contracted bona fide and for an adequate and full consideration in money or money's worth; * * *. There shall be disallowed the amount by which the deductions specified in paragraphs (1), (2), (3), and (4) exceed the value, at the time of the decedent's death, of property subject to claims. For the purposes of this section the term "property subject to claims" means property includible in the gross estate of the decedent which, or the avails of which, would, under the applicable law, bear the burden of the payment of such deductions in the final adjustment and settlement of the estate; and, for the purposes of this definition, the value of the property shall be reduced by the amount of the deduction under the next sentence attributable to such property. * * *

For the purposes of this subchapter, a relinquishment or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, shall not be considered to any extent a consideration "in money or money's worth."

* * * * *

(e) [As added by Sec. 361(a), Revenue Act of 1948, c. 168, 62 Stat. 110] *Bequests, Etc., to Surviving Spouse.*—

(1) *Allowance of marital deduction.*

(A) *In general.*—An amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to

the extent that such interest is included in determining the value of the gross estate.

* * * * *

(E) *Valuation of Interest Passing to Surviving Spouse.*—In determining for the purposes of subparagraph (A) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this subsection—

* * * * *

(ii) where such interest or property is incumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such incumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

* * * * *

TREASURY REGULATIONS 105 (1939 CODE)

SEC. 81.36. *Claims against the estate.*—The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent existing at the time of his death, whether or not then matured, and interest thereon which had accrued at the time of death. * * * Only claims enforceable against the decedent's estate may be deducted. Except as hereinafter stated, if the claim is founded upon a promise or agreement, the deduction therefor is limited to the extent that the liability was contracted bona fide and for an adequate and full consideration in money or money's worth. * * *

SEC. 81.47a [as added by T. D. 5699, 1949—1 Cum. Bull. 181, 195]. *Bequests, etc., to surviving spouse.*—(a) *Allow-*

ance of marital deduction. In the case of the estate of a citizen or resident of the United States dying after December 31, 1947, there may be deducted the value of any property interest (except as otherwise provided in section 81.47b and 81.47d) which passed from the decedent to his surviving spouse. Such deduction is hereinafter referred to as the "marital deduction." The marital deduction is generally not available in case the decedent's gross estate consists exclusively of property held by him and his surviving spouse as community property under the law of any State, Territory, or possession of the United States, or any foreign country. (See section 81.47d.) * * *

* * * * *

SEC. 81.47c [as added by T. D. 5699, 1949—1 Cum. Bull. 181, 206]. *Valuation of property interest passing to surviving spouse—*

* * * * *

(b) *Property interest subject to an incumbrance or obligation.* Section 812(e)(1)(E) provides that where a property interest passed from the decedent to his surviving spouse subject to a mortgage or other incumbrance, or where an obligation is imposed upon the surviving spouse by the decedent in connection with the passing of a property interest, the value of such property interest is to be reduced by the amount of such mortgage, other incumbrance, or obligation. The passing of a property interest subject to the imposition of an obligation by the decedent does not include a bequest, device, or transfer in lieu of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or

of other marital rights in the decedent's property or estate. The passing of a property interest subject to the imposition of an obligation by the decedent does, however, include a bequest, etc., in lieu of the interest of his surviving spouse under community property laws unless such interest was, immediately prior to the decedent's death, a mere expectancy. * * *

The following are illustrative of property interests which passed from the decedent to his surviving spouse subject to the imposition of an obligation by the decedent:

(1) A decedent devised a residence valued at $25,000 to his wife, with a direction that she pay $5,000 to his sister. For the purpose of the marital deduction, the value of the property interest passing to the wife is only $20,000.

* * * * *

(3) A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife.

* * * * *

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No. 54

In the

Supreme Court of the United States

OCTOBER TERM, 1963

UNITED STATES OF AMERICA,
Petitioner,

v.

DOROTHY ANNE STAPF AND B. T. WARE, II,
EXECUTORS AND TRUSTEES OF THE ESTATE
OF LOWELL H. STAPF, DECEASED, AND
DOROTHY ANNE STAPF, INDIVIDUALLY,
Respondents.

RESPONDENTS' PETITION FOR REHEARING

W. M. SUTTON,
P. O. Box 550,
Amarillo, Texas,

H. A. BERRY,
P. O. Box 550,
Amarillo, Texas,

JERRY F. LYONS,
P. O. Box 550,
Amarillo, Texas,

WINSTON R. SMITH,
P. O. Box 550,
Amarillo, Texas,
Attorneys for Respondents.

Of Counsel:
UNDERWOOD, WILSON, SUTTON, HEARE & BERRY,
P. O. Box 550,
Amarillo, Texas.

WARLICK PRESS, INC.—2265 VALDINA STREET—DALLAS—ME 1-3130

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Respondents.

RESPONDENTS' PETITION FOR REHEARING

Respondents pray that this Court grant rehearing of its opinion and decision of December 2, 1963, and that upon such rehearing the decision be modified and that it be directed that judgment be entered herein allowing a marital deduction for the property passing to Mrs. Stapf and the marital bequest arising through the debt and ~~extreme~~ EXPENSE assumption, subject to the limitation that the total marital deduction shall not exceed one-half the adjusted gross estate.

PRELIMINARY STATEMENT

Respondents accept as correct the Court's conclusion that the assumption provisions of the will with respect to the community debts and administration expenses constitute a marital bequest or gift to the surviving wife rather than creating deductible claims and expense in the decedent's estate. Respondents continue to urge, however, that such bequest, together with the testamentary devise of specific property to the surviving wife, qualifies for the marital deduction subject to the limitation that the total marital deduction cannot exceed one-half the adjusted gross estate.

GROUNDS FOR REHEARING

I.

In treating the property received by the children's trust as passing from the decedent through the wife, the opinion repudiates the controlling law of Texas, recognized by the Court, and effectively imposes an estate tax in decedent's estate on property never included in his estate.

II.

In holding the benefit to the surviving wife is the measure for determining herein the amount of the marital deduction, the opinion erroneously construes the marital deduction statute and the congressional intent in the adoption of such provision.

ARGUMENT IN SUPPORT OF GROUNDS FOR REHEARING

The decision erroneously treats two separate occurrences, each separately subject to different taxes (i.e., estate and

gift taxes), as one single occurrence subject to a single estate tax, whereby $106,268.00 passed from the deceased husband to his surviving wife under his will as a devise and the surviving wife surrendered her property of a gross value of $129,052.00 and a net value of $111,443.00

Such treatment violates the controlling Texas law of property rights recognized in the opinion. The opinion correctly states the applicable law on page 10 as follows:

> "Under a community property system, such as that in Texas, the surviving spouse receives outright ownership of one-half of the community property and only the other one-half is included in the decedent's estate. To equalize the incidence of progressively scaled estate taxes and to adhere to the patterns of state law, the marital deduction permits a deceased spouse, subject to certain requirements, to transfer free of taxes one-half of his non-community property to his surviving spouse."

As determined by the Court of Appeals herein (R. 71) and conceded by the Commissioner (page 5, note 4, of Petitioner's Brief), under the law of Texas the devise of 1/3rd of the whole community to the widow did not pass to her under the will, but was satisfied out of her own 1/2 of the community property. *Jones v. State*, Tex. Comm. of App. 1928, 5 S.W. 2d 973, and *Calvert, Comptroller v. Fort Worth National Bank*, Tex. Sup. Ct. 1962, 356 S.W. 2d 919. Thus, the only property passing from the decedent to the surviving widow was 1/3rd of his separate property and 1/2 the automobile of the value of $22,366.66 and the $17,610.00 debt assumption held by this Court to be a marital bequest.

This Court, in adopting Petitioner's characterization of the will as making a devise to a surviving spouse on condition that she "convey" property to a third party, necessarily recognizes that Mrs. Stapf, and not Mr. Stapf, made the transfer of her property to the children's trust. This is necessarily so because the title to Mrs. Stapf's 1/2 interest in the property was fully vested in her as is recognized by this Court, and such property was "conveyed" to the children's trust only as a result of her voluntary election to take under the will. It was her election and not the provisions of the will that "conveyed" *her property* to the children's trust. Her election, necessarily made after the death of the decedent, constituted the gift. There was no exchange of property between the testator and the surviving wife. By electing to take under the will, the widow's property did not become a part of the decedent's estate and taxable in his estate. GCM 7773, CB IX-2, Page 426, Ruling 33-4750. *Coffman-Dodson Bank & Trust Co., Executor*, 40 B.T.A. 890; *The Pacific National Bank of Seattle, Executor*, 40 B.T.A. 128; *Merten's Law of Federal Gift and Estate Taxation*, Sec. 11.02, Vol. 1, Page 687.

To say, therefore, as the opinion variously and contradictorily says, that the decedent devised part of Mrs. Stapf's own property to her, or to say that the decedent transferred part of his property to the children "through" the surviving wife, or that the *decedent* effectively transferred part of Mrs. Stapf's property to the children repudiates the recognized and controlling provisions of Texas law.

Treating the $17,610.00 debt and expense assumption as a marital bequest, as well as the $22,366.66 bequest of decedent's separate property and his community interest in the family automobile, as passing to the surviving wife under the will of the decedent, as is required by Texas law, the amount of the fully vested property transferred or "conveyed" by the surviving wife is $45,151.00, representing the difference between her 1/2 of the gross community property in the amount of $129,052.00 and $83,901.00 being 1/3rd of the gross community property remaining after satisfying special bequests first provided for in the will.

Such a transfer or conveyance to third parties is recognized by all as having gift tax consequences.

The fact (if it is a fact) that under the gift tax statute the surviving wife may be entitled to deduct, in determining her taxable gift, what she received from her husband, does not warrant or authorize the imposition of an estate tax in the decedent's estate on the property received by the surviving spouse under the decedent's will in the absence of clear statutory language in the estate tax statute so requiring such an imposition. As held by the Court of Appeals herein, this is a matter for Congressional action.

By denying a marital deduction, for property passing from the decedent to the surviving spouse an estate tax, at estate tax rates, is effectively levied on property that is subject only to gift tax consequences and the property passing to the surviving wife is actually taxed twice, once in the decendent's estate and again in the estate of the surviving spouse. By the adoption of the marital deduction provisions

in the Revenue Act of 1948, Congress directed that such property so passing should only be taxed once for estate purposes and not twice as was the case during 1942 to 1948, and as will be the case under the decision herein.

Respondents respectfully submit that for this Court to assume that only $5,175.00 of Mrs. Stapf's gift to the children's trust, instead of the full gift of $45,151.00, will be subject to gift tax, is to prejudge and decide such issue before such question has been presented for decision.

In determining the gift tax liability of a surviving wife who elects to take under her husband's will, the question of whether the amount received by the wife under the will can be deducted from the amount which she gives out of her separately owned community property to a testamentary trust has never been presented to this Court for decision. One Circuit Court opinion and three Tax Court opinions,[1] none of which have been reviewed by this Court, so hold. The correctness of such decisions is open to question. None of these cases involve the exact fact situation here presented. For this Court to conclude that Mrs. Stapf's gift of $45,151.00 will escape gift taxes on $39,976.00 (value of the property passing from the decedent) is to approve the holdings of the lower courts on such question before such issue is presented to this Court.

By treating any part of the *decedent's* property as passing to the children's trust *through* the surviving wife, and by

[1] Commissioner of Internal Revenue v. Siegel, C.A. 9, 250 Fed. 2d 339; Chase National Bank, 25 T.C. 617, reversed on other grounds 259 Fed. 2d 231 C.A. 5; Zillah Mae Turman, 35 T.C. 1123; Estate of Lillian B. Gregory, 39 T.C. 1012.

treating the $106,268.00 estate owned by the widow after her election as being *devised* to her by her husband, the opinion not only fails to properly apply Texas law but fails to effectuate the purpose of Congress in repealing the 1942 Amendment to the estate tax statute and adopting the marital deduction provisions in the Revenue Act of 1948.

Prior to 1942 an estate tax was levied, in a community property state, on only the decedent's one-half interest in community property and upon such separate property as he might own. Section 402 of the Revenue Act of 1942 amended Section 811 (e) of the Internal Revenue Code of 1939 by levying an estate tax upon the entire community of both spouses upon the death of the first of such spouses to die. The Congressional purpose in the 1942 amendment was described in *Fernandez v. Wiener*, 1945, 306 U.S. 340, as being "* * * the elimination of what was believed to be an unequal distribution of the tax burdens of estate taxes* * *."

As appears from Senate Report 1013 of the Committee on Finance and House Report 1274 of the Ways and Means Committee, the 1942 amendment not only failed to produce geographical equalization but produced other results, detailed in such reports, even more undesirable which led to the recommendation by both such committees that the 1942 amendment be repealed and the marital deduction provision here in issue be adopted.[2]

[2] See Senate Report 1013, Section VIII, B, Pages 1188, 1189, U.S. Congressional Service, Part 2, Eightieth Congress, Second Session, 1948, and House Report No. 1274, Section VIII, B, Page 1272, U.S. Congressional Service, Part 2, Eightieth Congressional Service, Second Session.

In the "Summary of Changes in Existing Law" in Senate Report 1013[3] it is stated:

> "The 1942 amendments to the estate and gift taxes which provided special rules in the case of community property are repealed* * *. Generally, this restores the rule by which estate and gift-tax liabilities are dependent upon the ownership of property under State law. Thus, in community property states, irrespective of which spouse dies first, only one-half of the community property is included in the gross estate."

The Respondents respectfully submit the opinion herein effectively amends the estate tax statute by failing to fix the estate tax liability in accordance with the ownership of property under the law of the decedent's domicile where all the property was located.

With due deference to the Court, it is submitted that a reading of the entire Senate Report 1013, insofar as any reference to estate and gift taxes is made, reflects an intent that the net value of the property passing from the decedent, and not the net benefit to the surviving spouse resulting from a family transaction in which her property passes to third parties by reason of her election, is the standard for measuring the permissible marital deduction.

This intent is emphasized when it is considered that the proper application of State law, governing the ownership of property and its passage under a will, does not treat, contrary to the treatment herein, any of the surviving wife's community property as passing from the decedent to her and does not treat any of the surviving wife's community

[3] Senate Report 1013, Section II, B, Page 1167, U.S. Congressional Service, Part 2, Eightieth Congress, Second Session, 1948.

property as passing to third parties from the decedent through her, but treats such property as passing *from her* and not from the decedent *through her*.

For convenience Respondents are copying as Appendix A to this motion that portion of Supplementary Report 1013 of the Senate Committee on Finance under Part II, Subpart 2, directly dealing with Subparagraph E of Section 812(e) (1) appearing at page 1227-1228 U. S. Congressional Service, Part 2, Eightieth Congress, Second Session, 1948. This excerpt should be read in context with the remainder of the Report, however, to gain the full import.

It is to be noted that Clause (i) of Subparagraph E of Section 812(e) (1) of the Revenue Code refers to "net value to the surviving spouse of such interest", whereas Clause (ii) refers to "the amount of a gift to such spouse of such interest."

Clause (i) relates to the effect that estate and inheritance taxes, levied directly upon and with respect to the property passing to the surviving spouse, have upon the value of such property and requires that the material deduction be reduced by the amount of such taxes since they are a charge upon the property itself, actually reducing the net value that can pass or be received. The meaning is clarified by Section 812(d) of the Code, reference to which is required by the statement in the Senate Report which reads:

> "This provision is substantially the same as that provided in Section 812(d) of the Code, relating to bequests, etc. to charity."

Such Section 812(d) clearly refers to taxes that are payable out of the specific bequest, devise or legacy, thereby reducing the actual value of the property received. The purpose of the provision and all reference to the "net value to the surviving spouse" are clarified in the statement in the Senate Report referring to Clause (i): "This provision is designed to prevent any implication that such taxes should not be taken into account where such taxes and the marital deduction are mutually interdependent."

The Senate Report describes Clause (ii) as requiring a different standard of measurement in valuing interests passing that are subject to encumbrances or obligations. Such standard of measurement is "as if the value of a gift to the spouse of an interest passing were being determined."

The illustration of mortgaged property passing to the surviving spouse makes it clear that the value of the property is reduced by the amount of the mortgage unless the executor is directed to discharge the mortgage from other property. The illustration of property being given to the wife subject to a charge on the property for the payment of $1,000.00 to X is no different in purpose. If the obligation to X is that of the decedent or a charge on the property, the value of the property passing is necessarily reduced by such $1,000.00 payment, whether paid by the Executor from the property with only the net value thereof passing or paid by the surviving wife out of the gross property passing. This is apparently the type of situation contemplated by the illustration. In a common law state this would be

required because usually all property passes by the husband's will, and any payment by the wife would have to be made out of such property unless she had separate property.

The actual value of property included in the gross estate and passing under the will is unaffected by the fact that the wife makes payment to a third party out of her separate funds if the payment to such third party was not an obligation of the decedent or a claim upon his estate. The Committee Report is carefully worded, and the fact that the illustration does not require the payment to X to be made out of the wife's separately owned property is clear evidence that the committee did not have in mind the construction placed upon such illustration by the opinion herein.

Respondents' contention that the illustration of the payment to X refers to the payment of a claim against, or an obligation of, the decedent, is fortified by the explanatory paragraph that follows the illustration. It is there stated "The interest passing to the surviving spouse from the decedent is only such interest as the decedent can give." This is followed by an illustration comparable to the illustration of the payment by the wife to X. It is pointed out that if a decedent leaves the residue of his estate to his surviving wife and she pays, or the estate income is used to pay, claims against the estate so as to increase the residue, such residue is acquired by purchase and not by bequest. Accordingly, the value of the additional part of the residue so acquired by purchase cannot be included in the marital deduction.

The illustrations used in the Senate Report clearly evidence that the Senate Committee on Finance was thoroughly familiar with the established rules of law for measuring the amount of a gift for gift tax purposes. Respondents know of no statutory provisions or any decision that fixes or establishes a standard for determining the amount of a taxable gift to a wife different than the standard used for measuring a gift to any other person. Neither the Government's brief nor the opinion herein refers to special rules for measuring the amount of a gift to a wife. *Lowndes & Kramer, Federal Estate and Gift Taxes*, 1962 Edition, Page 684, Section 32.4, citing *Commissioner v. Wemyss*, 324 U. S. 303, 307-308, accurately states the rule as follows:

> "According to the Supreme Court the consideration necessary to prevent a taxable gift must not only be adequate and full and capable of expression in money or money's worth, but it must also take the form of a benefit to the transferor rather than a detriment to the transferee."

The same rule is stated in *Commissioner of Internal Revenue v. Bristol*, CCA 1st, 121 Fed. 2d 129, cited in *Commissioner v. Wemyss*, and is further illustrated in *Estate of Koert Bartman*, 10 T.C. 1073; *Estate of John M. Goetchins*, 17 T.C. 495; and *Estate of B. Gwinn*, 25 T.C. 31; and *Wachovia Bank & Trust Co. v. United States* (Ct. of Cl. 1958) 163 Fed. Supp. 832. To same effect see *Mertens' Law of Federal Gift and Estate Taxation*, Vol. 1, Page 287, Sec. 5.11 and Vol. 5, Page 92, Sec. 34.18.

Under the rationale and direct holding of *Commissioner v. Wemyss*, the transfer or conveyance by Mrs. Stapf to the

children's trust was not a consideration in money or money's worth passing to Mr. Stapf that would reduce, for gift purposes, the taxable value passing to Mrs. Stapf. Since the standard for measuring the value of the property passing for marital deduction purposes is the value or amount of the property transferred for gift tax purposes, the amount of the property passing under the decedent's will should be measured by the value of such property and not by the net benefit to the recipient.

Regulation 108, Section 86.3, applicable to the 1939 Code (Sec. 25.2611-2 of current regulations applicable to 1954 Code), referring to the gift tax states:

> "(a) In general. —The tax is not imposed upon the receipt of the property by the donee, *nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer*, nor is it conditioned upon ability to identify the donee at the time of the transfer. *On the contrary*, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, *is measured by the value of the property passing from the donor*, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable." (emphasis supplied)

Thus, if any effect is to be given to the last part of Clause (ii), as must be done, the gift tax statute, the regulations thereunder and the decisions construing the gift tax statute appear to the Respondents to require that the marital deduction be allowed for the actual value of the property passing, and not merely for the resulting benefit to the surviving spouse remaining after she in turn has voluntarily

made a taxable gift of her separately owned property to a third party where such payment constituted neither an encumbrance nor obligation of the decedent.

To construe the illustration of the payment to X or the language in Clause (ii) of the statute, "with respect to the passing of such interest," as referring to the net benefit received by the wife, creates an irreconcilable conflict with the last part of such clause, requiring the encumbered property, or property subject to an obligation, to be valued "as if the amount of a gift to such spouse of such interest were being determined". Furthermore, a conflict is thereby created with the controlling cases holding that the amount of a gift, for gift tax purposes, is not to be measured by the net benefit to the recipient but by the amount of property actually transferred reduced only by a monetary consideration passing to the donor.

Since such illustration is, to say the least, subject to conflicting constructions, Respondents submit that same should be construed in harmony with the statutory language requiring the property passing to be measured as if the amount of a gift to such spouse of such interest were being determined.

Respondents respectfully submit that the Court is in error in its statement, "Respondents' construction of Section 812(e)(1) would nevertheless, permit one-half of a spouse's wealth to pass from one generation to the other without being subject to either gift or estate taxes," even if you assume the widow's gift to her children is reduced for gift tax purposes by the devise to her of a part of her husband's

property. The tax free passage of *one-half* of the decedent's property, would occur only where, 1. the decedent owned *only* separate property in which the surviving spouse owned no interest, and 2. the surviving wife owned *only* separate property, not affected with a community property interest or any other interest in her husband. Such a rare situation, though unlikely to occur, could arise in either a community property state or a common law state with equal frequency.

In a community property state, no property could be transferred free of tax if all of the property was community property, which is the usual situation, because no marital deduction would be available. If any community property is owned and the husband additionally owns separate property, the maximum marital deduction would not in any case exceed one-half of the value of the husband's separate property. If in a common law state the wife owned no separate property, there would be no property that she could transmit or convey by gift, and, therefore, no property would pass free of gift taxes.

It is further submitted that the Court's conclusion based upon the statement in 76 Harvard Law Review, 1671, 1675, that the adoption of the Respondents' position would create an "opportunity for tax reduction" that "would be more readily available to couples in community property jurisdictions than to couples in common law jurisdictions" is erroneous. As we have seen, "such an opportunity for tax reduction", in any amount, can occur in a community property state only where the decedent owns separate property, in which the surviving spouse has no interest

whatsoever, and can occur in a common law state only where the wife has separate property in which the husband has no interest or right of control. Since the author of the Harvard Law Review does not quote statistics to establish that there are more husbands in community property states who own separate property than there are wives in common law states who own separate property, the Law Review writer's conclusion accepted by this Court is open to question.

CONCLUSION

It is respectfully submitted that the Court's conclusions: 1. that any part of the surviving wife's community property was devised to her by her husband, and 2. that the will passed or had the effect of passing any part of the surviving wife's separately vested community property to third parties, and 3. that the decedent passed any of his property or his wife's property through the surviving wife to the Trustees for the benefit of the children, are all contrary to the recognized and established law of Texas governing the ownership of property and the passage of property by will, resulting in the improper denial of the marital deduction with respect to property of the decedent passing to the surviving wife under State law, upon which law the estate tax liabilities are dependent and are fixed. For the reasons herein advanced, Respondents additionally submit this Court erred further in concluding that since the surviving wife received no net benefit, the estate is entitled to no marital deduction.

Respondents pray that a rehearing be granted, and that upon rehearing, it be ordered, adjudged and decreed that

a marital deduction in the amount of $39,963.00 be allowed, subject to the limitation that such marital deduction shall not exceed 1/2 the adjusted gross estate, and that this case be remanded for proceedings in accordance with such decision.

Respectfully submitted,

W. M. SUTTON,
H. A. BERRY,
JERRY F. LYONS,
WINSTON R. SMITH,
P. O. Box 550,
Amarillo, Texas,
Attorneys for Respondents.

By W. M. SUTTON
W. M. SUTTON

Of Counsel:
UNDERWOOD, WILSON, SUTTON, HEARE & BERRY
P. O. Box 550,
Amarillo, Texas.

CERTIFICATE OF COUNSEL

I hereby certify that the foregoing PETITION FOR RE-HEARING is presented in good faith and not for delay.

W. M. SUTTON
W. M. SUTTON
Counsel For Respondents.

APPENDIX A

Extract from Supplementary Report 1013 of Senate Committee on Finance, Part II, Subpart 2, pages 1227-1228, United States Congressional Service, Eightieth Congress, Second Session, 1948.

Subparagraph (E) of section 812 (e) (1) specifically provides for the application in determining the value of any interest in property passing to the surviving spouse of rules which are generally applicable in determining the net value of any gift or bequest. Clause (i) of such subparagraph requires that there shall be taken into account the effect which the amount of any estate, succession, legacy, or inheritance tax may have upon the net value of any interest in property passing to a surviving spouse. This provision is designed to prevent any implication that such taxes should not be taken into account where such taxes and the marital deduction are mutually interdependent. This provision is substantially the same as that provided in section 812 (d) of the code, relating to bequests, etc., to charity. The rule applies where the burden of a death tax falls upon the surviving spouse or the property in which an interest passes to the surviving spouse.

Clause (ii) of such subparagraph (E) directs that in determining the value of any interest passing from the decedent to the surviving spouse, incumbrances or obligations shall be taken into account in the same manner as if the value of a gift to the spouse of the interest passing were being determined. This is a clarification which was not expressed in the bill as passed by the House. If the decedent by his will leaves to his surviving spouse real estate subject to a mortgage (whether or not such mortgage was personal liability of the decedent) the value of the interest passing to the surviving spouse does not under this section include the mortgage. If, however, the decedent by his will

directs the executor to pay off the mortgage, such payment constitutes an additional interest passing to the surviving spouse. If the decedent bequeaths certain property to his surviving spouse subject, however, to her agreement, or a charge on the property, for payment of $1,000 to X, the value of the bequest (and, accordingly, the value of the interest passing to the surviving spouse) is the value, reduced by $1,000, of such property.

The interest passing to the surviving spouse from the decedent is only such interest as the decedent can give. If the decedent by his will leaves the residue of his estate to the surviving spouse and she pays, or if the estate income is used to pay, claims against the estate so as to increase the residue, such increase in the residue is acquired by purchase and not by bequest. Accordingly, the value of any such additional part of the residue passing to the surviving spouse cannot be included in the amount of the marital deduction.